

“Priority Rights of Creditors in Insolvency”

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Published Work submitted to the University of Wolverhampton for the degree of Doctor of Philosophy

July 2003

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Abstract

Although it is a fundamental principle of insolvency law that all creditors are treated equally (the *pari passu* principle), in practice this principle is subject to a number of important exceptions. The principal exceptions are the respective rights of secured creditors, preferential creditors, landlords and execution creditors. The body of work contains a number of peer refereed articles in all these areas, in relation to both corporate and individual insolvency. In addition to an historical approach and a doctrinal approach, certain parts of the body of work also contain theoretical discussions and some empirical research. A number of the articles being submitted have been the subject of many citations by learned authors in the area. In addition one article has been cited by the New Zealand High Court and the New Zealand Law Commission has quoted from another article. The body of work is original in that it contains new ideas or views matters with a new approach.

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Published Works

Gregory and Walton “Fixed Charges over Changing Assets - The Possession and Control Heresy” (1998) 2 *Company, Financial and Insolvency Law Review* 68-87

Gregory and Walton “Book debt charges - the saga goes on” (1999) 115 *Law Quarterly Review* 14-17

Gregory and Walton “Book Debt Charges: Following Yorkshire Woolcombers – are we sheep gone astray?” [2000] *Insolvency Lawyer* 157-168

Walton “Partnership Floating Charges – opening a can of worms?” (2000) 4 *Receivers, Administrators and Liquidators Quarterly* 241-262

Gregory and Walton “Fixed and Floating Charges - A Revelation” [2001] *Lloyds Maritime and Commercial Law Quarterly* 123-149

Keay and Walton “The Preferential Debts Regime in Liquidation Law: In the Public Interest?” (1999) 3 *Company, Financial and Insolvency Law Review* 84-105

Keay and Walton “Preferential Debts: An Empirical Study” [1999] *Insolvency Lawyer* 112-118

Walton “The Landlord, his distress, the insolvent tenant and the stranger” (2000) 16 *Insolvency Law and Practice* 47-53

Walton “Landlord's Distress – past its see by date?” [2000] *Conveyancer* 508-527

Walton “Execution Creditors – (almost) the Last Rights in Insolvency” [2003] *Common Law World Review* 179-210

Inclusive Bibliography

Commentary

The overriding purpose of the collected publications was to consider the rights held by different types of creditors upon the insolvency of a debtor. It has long been an interest of the candidate that rights of different types of creditor in formal insolvency procedures vary so much. Whenever specific rights of certain types of creditors are analysed by government or other committees, it is rare that those creditors' rights are considered in the context of insolvency law. Similarly, when insolvency law is considered by official bodies, the individual rights of different types of creditors are not usually looked at in any detail. When one considers that the main thing a creditor is interested in is getting paid, no matter what the circumstances of the debtor may become, this is an area requiring greater consideration.

The research methodology of the published material was in general limited to historical and doctrinal analysis but also included an element of empirical work and theoretical discussion (in the works on preferential creditors).

In this commentary it is proposed to deal with the published works on a subject by subject basis. Where a particular article has been cited elsewhere (to the knowledge of the candidate), such citations are noted.

The starting point will be an explanation of the work done in the area of secured creditors' interests. This will concentrate on the research covering unincorporated lending and, in the modern context, more importantly, the most common corporate lending mechanisms of fixed and floating charges.

The next type of creditor to be considered will be the preferential creditor. Although the passing of the Enterprise Act 2002 has greatly reduced the current importance of this research, the published works in this area appear to have been well received and have added to the debate.

A landlord has a number of rights peculiar to his or her status. Arguably the most controversial of these rights is the power to distrain for unpaid rent. The published works consider the nature of this right and how it operates in the formal insolvency of a debtor.

The final type of creditor considered is the execution creditor. As will be seen, the doctrinal investigation of the rights of an execution creditor in the insolvency of a debtor shows up a wide discrepancy as to the creditor's rights, depending upon what type of execution is employed, and what type of formal insolvency procedure the debtor has entered.

Note regarding co-authored works. The list of published works contains materials co-written with Roger Gregory and Andrew Keay. Some explanation of the respective input of the candidate and co-authors is required by the University's Regulations. I have enjoyed the rare privilege of co-writing with two such able and well known academics.

The input of the co-authors, although not capable of exact quantification, was, in the opinion of all the parties involved, equal.

The way in which Roger and myself approached our research was a little different to the modus adopted by Andrew and myself. In terms of working with Roger, we adopted a not altogether efficient approach of both reading everything either of us could find, meeting to plan the various articles, and generally sitting together to draft the pieces. Working with Andrew was a little more efficient in that we met to devise how we would approach the research and then effectively split the main tasks between us so that we each took primary responsibility for particular matters prior to meeting up to complete jointly, a final edit. The empirical research we undertook involved us jointly brainstorming the issues we wanted to look at, and then jointly drafting the questionnaire. We met to analyse the results jointly.

Secured Creditors' Interests

Articles

"Fixed Charges over Changing Assets – the Possession and Control Heresy" (1998) 2 CfiLR 68-87 Co-author Roger Gregory (hereafter referred to as "*Heresy*")¹

"Book debt charges – the saga goes on" (1999) 115 LQR 14-17 Co-author Roger Gregory (hereafter referred to as "*Saga*")²

"Book Debt Charges: Following *Yorkshire Woolcombers* – Are We Sheep Gone Astray?" [2000] *Insolvency Lawyer* 157- 168 Co-author Roger Gregory (hereafter referred to as "*Sheep*")³

"Partnership Floating Charges – Opening a Can of Worms?" (2000) 4 RALQ 241-262 (hereafter referred to as "*Worms*")

"Fixed and Floating Charges – A Revelation" [2001] LMCLQ 123-149 Co-author Roger Gregory (hereafter referred to as "*Revelation*")⁴

¹ Cited in *Re Brumark Investments Ltd* (1999) 19 NZTC 15,159, 15,164 per Fisher J; J Lee Suet Lin "Company Charges under Singapore Law: Legal and Practical Implications" (2003) 14 ICCLR 1; P Watts "The Rending of Charges" (2002) 118 LQR 1, 3; D Capper "Fixed Charges Over Book Debts – Back to Basics but How Far Back?" [2002] LMCLQ 246, 247 and 256; MA Armstrong "Return to First Principles in New Zealand: Charges over Book Debts are Fixed – but the Future's not" [2000] *Insolvency Lawyer* 102; D Capper and L McHugh "Whither the Floating Charge" [1999] *Insolvency Lawyer* 162.

² Cited in argument in *Agnew v Commissioner of Inland Revenue* [2001] 2 AC 710, 713; D Mclauchlan "Fixed Charges Over Book Debts: New Bullas in New Zealand" (1999) 115 LQR 365, 367; D Capper and L McHugh "Whither the Floating Charge" [1999] *Insolvency Lawyer* 162; A Walters "Round Up: Corporate Finance and Receivership" (1999) 20 *Company Lawyer* 324; V Finch *Corporate Insolvency Law Perspectives and Principles* 2002 Cambridge at 103, 305, 308.

³ Cited in V Finch *Corporate Insolvency Law Perspectives and Principles* 2002 Cambridge at 305, 308.

⁴ Cited in R Goode *Legal Problems of Credit and Security* 3rd ed. 2003, Sweet and Maxwell at 113; L Gulliver "Will the Law Commission Sink the Floating Charge?" [2003] LMCLQ 125, 126 and 135; J Lee Suet Lin "Company Charges under Singapore Law: Legal and Practical Implications" (2003) 14 ICCLR 1;

Commentary

My former mentor and colleague Roger Gregory and I have long considered the accepted wisdom on fixed and floating charges to be fundamentally flawed. We were both weened on Professor Pennington's seminal article "The Genesis of the Floating Charge" and whilst accepting most of the points made therein, felt that there was more to be found. It has always seemed to both of us that the idea that "fixed" security should by definition cause paralysis of a business was somewhat illogical. It is generally accepted that a company whose assets are subject to fixed security can deal with those assets, only if it obtains the consent of the security holder for each individual dealing. A general licence given to the company to deal with the fixed charge property is not possible. This restrictive approach to freedom of contract seemed to us unjustified and so, armed with a copy of *Holroyd v Marshall* we decided to look more deeply into the question.

Our initial researches were essentially historical in that we wanted to look at what the position was regarding consensual security mechanisms prior to the invention of the floating charge. We concentrated on the requirement in the modern book debt cases that the debenture holder must control the bank account into which the book debt proceeds are paid, in order for the security to be fixed in nature. In the *Heresy*, we traced a good deal of case law involving unincorporated secured borrowing and found an enormous amount of authority which states that for mortgage security over changing personalty, there has never been a requirement in equity for the mortgagee to have possession or control over the mortgaged assets. In equity, a mortgage of future personalty attaches to mortgaged assets the moment those assets come into existence. No further conveyance or act, such as taking possession, is needed to obtain a good equitable title.

The purported need to show possession of charged assets has been discounted in some of the leading modern cases but the same judges do require control of the bank account when it comes to fixed charges over book debts. In the *Heresy*, we considered how mortgages of, for example, book debts and stock in trade, in the unincorporated sector never required any element of control or possession and that this requirement was only introduced in the cases dealing with corporate lending. To some extent, the problems thrown up by the Bills of Sale Acts, which were, it appears, at least partly responsible for the introduction of the equitable charge, caused some confusion at the same time that the floating charge was being adopted. The courts never expressly addressed whether a security document drafted on the one hand, as a mortgage, or on the other, as a charge, would have made any difference. The modern tendency to view charges and mortgages as the same thing, is legally unsound and leads to potentially vague and generalised interpretations of carefully drafted documents. We wonder whether, if the modern courts had to construe a nineteenth century precedent mortgage bill of sale, they would follow the old authorities or reassess it in light of the modern authorities.

An important and related point is that the modern courts have insisted, that if the chargor company has a power to deal with charged assets without the necessity of acquiring individual chargee consent, the charge cannot be fixed and must float. In the *Heresy*, we give a number of clear examples of mortgage bills of sale where a power to deal is perfectly acceptable. Although we identify considerable conflicts between the unincorporated and corporate case law on securities, we were at this time unable to find exactly how and when these inconsistencies came about. Crucially, our understanding of *Florence Land* at this time was incomplete and it was not until we wrote *Revelation* that all the parts fell into place.

The main theme that possession or control should not be a requirement for a fixed charge was taken up in *Sheep*. Although we were firmly of the view that possession or control should not be necessary and that a power to deal with secured assets could be express or implied, the one main authority against us, in a corporate context, is *Re Yorkshire Woolcombers*. In order to convince the reader that we had a valid point, we decided to dissect this case and highlight how each individual basic tenet of it was, in law, misconceived. An appendix of cases attached to the end of the article was intended to persuade the reader that there is far more authority against *Woolcombers* than there is in support of it. Perhaps the most important point made here is that Farwell J, at first instance, insists upon chargee possession for the existence of a fixed charge. His Lordship cites no authority for this proposition but it appears to have been accepted without demur by the Court of Appeal and the House of Lords. It is particularly difficult to reconcile the majority decision in *Tailby* with the decision in *Yorkshire*.

The *Saga* looks at three cases circa 1998 and highlights the problems faced by the courts at this time, in establishing the boundaries between fixed and floating charges. The amount of control or the nature of the restrictions necessary to establish a security as a fixed charge remained at this time uncertain, largely due to the obvious contradictions between some of the modern cases and some older and more considered decisions such as *Holroyd*.

The matter which had always caused us the most concern, and to which no adequate explanation had been offered by anyone, was how could the modern cases be so obviously at odds with the older authorities. Something happened in the mid to late nineteenth century which caused the courts suddenly to refuse to recognise fixed security with chargor possession and a power to deal. In order to track down this “holy grail” we decided to re-read all the cases we had looked at. The origins of the floating charge were reasonably explicable and comprehensible, but the sudden adoption of the view that fixed security caused paralysis of the business appears first in Sir George Jessel’s judgment in *Re Florence Land*. It would seem highly unlikely that such a brilliant Chancery judge would have got it wrong, but it is not readily apparent what authority his Lordship was relying on for his decision. The answer to this conundrum came by re-reading some of the common law decisions on future property mortgages.

We had not paid much attention to these before because we were aware that the common law cases were against the future property mortgage with power to deal and we were

primarily interested in equity's approach. On looking again at *Graham v Chapman*, it immediately bore comparison with the language used by Jessel. On further examination, it became tolerably clear that the reasoning in *Graham*, a bankruptcy case, had been imported into company liquidation law, by s10 of the Judicature Act. Although *Graham* itself was not a popular decision, it was law at the time of *Florence Land* and this is where the idea that fixed security caused paralysis came from. *Graham* was shortly thereafter overruled, but in the corporate sector, the idea of fixed charges with a power to deal being a conceptual impossibility had taken off. The reasoning in *Graham* is inconsistent with a vast number of cases decided in equity and this is why the modern case law, whose lineage is traceable from *Florence Land* through *Yorkshire* to the modern decision of *Brumark*, is doctrinally inaccurate.

One interesting theme which runs through the whole of the area of creditor interests in insolvency is the effect of s10 of the Judicature Act. Its impact on fixed and floating charges appears never to have been recognised and, as will be demonstrated later, its impact upon the rights of preferential creditors, landlords and execution creditors was also significant.

The other article in this area, *Worms*, considers what the effect is likely to be of the Law Commission's proposal to create a new type of registered partnership and to exempt this new business medium from the provisions of the Bills of Sale Acts. The Law Commission is of the view that such a new type of partnership would choose to create floating charges, which undoubtedly it could. The suggestion in the article is that a partnership, freed from the restrictions of the Bill of Sale Acts, would provide a more effective security for a debenture holder by executing an old style mortgage bill of sale rather than a floating charge. The mortgage has any number of precedents dating from the nineteenth century and arguably should not be subject to the vagaries of the modern corporate case law on fixed and floating security. If this did occur, it would potentially re-ignite the debate which took place around a century ago, as to whether any all encompassing type of security over future property should be permitted. It is certainly not easy to put forward arguments based upon fairness to creditors to justify the existence of such security devices.

Preferential Creditors

Articles

"The Preferential Debts Regime in Liquidation Law: In the Public Interest?" (1999) 3 CfiLR 84-105 Co-author Andrew Keay (hereafter referred to as "*Public Interest*")⁵

⁵ Cited in the New Zealand Law Commission Paper "Priority Debts in the Distribution of Insolvent Estates (An Advisory Report to the Ministry of Commerce) October 1999 NZLC SP2 at 27, 28; G McCormack "The Priority of Secured Credit: an Anglo-American Perspective" [2003] JBL 389, 393; J Lee Suet Lin "Company Charges under Singapore Law: Legal and Practical Implications" (2003) 14 ICCLR 1; G McCormack "The Floating Charge and the Law Commission Consultation Paper on Registration of Security Interests" [2003] *Insolvency Lawyer* 2; G McCormack "The Nature of Security over Receivables" (2002) 23 *Company Lawyer* 84; ; R Mokal "Priority as Pathology : The Pari Passu Myth" (2001) 60 CLJ 581 at 581, 582, 585, 586, 590, 591, 596, 606, 609, 612, 614, 615, 618; A Walters "Round Up: Corporate

“Preferential Debts: An Empirical Study” (1999) *Insolvency Lawyer* 112-118 Co-author Andrew Keay (hereafter referred to as “*Empirical Study*”)⁶

Commentary

The purpose of this research was to consider generally the preferential debts regime. Although there was a certain amount of pre-existing comment on the system, it mostly considered only certain aspects of the preferential debts system. Our intention with this study was to look at preferential debts from an historical, doctrinal, policy and empirical perspective. Although some other commentators had looked at policy arguments for and against the system, there was surprisingly not much said about the history of the regime. Similarly, no-one had attempted to assess the impact of the regime on practical day to day insolvencies.

The results of our research were not quite as self evident as may have been thought.

The history of the preferential debts regime begins with the Crown prerogative. In the bankruptcy of an individual, the Crown’s rights would generally prevail over those of the bankrupt’s other unsecured creditors. As long as the Crown claimed its rights prior to the formal assignment of the bankrupt’s assets to the assignee in bankruptcy, the Crown, not being subject to the Bankruptcy Act’s doctrine of relation back, would take priority. There is some evidence from the early nineteenth century that the courts would go out of their way to prevent the Crown succeeding in such claims by ordering the assignment at very short notice. Until 1883, the Crown was not stated to be bound by the terms of the Bankruptcy Act and therefore could in theory ignore its provisions. The Crown’s rights had been cut down by the Bankruptcy Acts of 1849 and 1869, and these restrictions appear to have been accepted by the Crown even though no express mention was made therein as to the binding effect on the Crown.

Under the Companies Act 1862, again no mention was made as to any of the restrictions on actions against the company in liquidation being binding upon the Crown. Section 10 of the Judicature Act 1875 provided that “the same rules shall prevail and be observed as to the respective rights of secured and unsecured creditors” in the liquidation of companies as existed in the bankruptcy of individuals. The courts seem to have ignored this provision in liquidation. Even the very clear wording of later statutory amendments was overlooked. It was not until 1922 that the courts finally accepted that the Crown’s rights in liquidation were to some extent abrogated.

Insolvency” (2000) 21 *Company Lawyer* 262; A Walters “Round Up: Corporate Finance and Receivership” (1999) 20 *Company Lawyer* 324; V Finch *Corporate Insolvency Law Perspectives and Principles* 2002 Cambridge at 430, 436; I Fletcher, *The Law of Insolvency*, 3rd ed, 2002, Sweet and Maxwell at 660; V Finch and S Worthington “The Pari Passu Principle and Ranking Restitutionary Rights,” Chapter 1 in Francis Rose (editor), *Restitution and Insolvency*, Mansfield Press, 2000 at 4 and 6.

⁶ Cited in V Finch *Corporate Insolvency Law Perspectives and Principles* 2002 Cambridge at 428, 430, 432.

From the Companies Act 1929 up to the Cork recommendations being put into effect, the Crown (and other public bodies) slowly had their preferential rights extended. These were reduced markedly following Cork. At the time of the drafting of the two articles included in this publication, the Crown's preferential rights had begun to expand again. Now, of course, the Crown has lost its preferential status entirely under the Enterprise Act 2002.

The preferential status of employees was introduced into England and Wales in 1825 and remained a valuable claim up until recent times. The current financial limit of £800, in modern times, is frequently only a small fraction of what an employee is actually owed by an insolvent employer. This shortfall is to some extent made up from claiming against the National Insurance Fund. The arguments for protecting employees from the insolvency of employers are just as strong today as they were in 1825. With the protection afforded by the Employment Rights Act, the status of employees as preferential creditors would seem to be a needless additional protection. This is especially so, when one considers that the government has a right of subrogation from the employees' preferential claim for any National Insurance Fund payments made.

The fundamental policy underpinning insolvency law of *pari passu* treatment for unsecured creditors is ignored by the preferential debts regime.

In considering the Crown's preferential status, in the *Public Interest*, we considered arguments in favour of the Crown's rights being retained. These arguments are based upon the related ideas that the Crown is an involuntary creditor and that debts owed to it are debts owed to the community at large.

Against retention of such rights it is argued that debts owed to the public exchequer are insignificant compared to the total government income. The Crown, with its potentially detailed knowledge of a particular debtor, is arguably in a better position to protect itself than ordinary trade creditors. Contrary to accepted wisdom on the subject, 82% of the insolvency practitioners surveyed, did not believe that the Crown's preferential status made it less likely to initiate winding up proceedings. If the preferential creditors sit back and take no action against insolvent companies, unsecured trade creditors are unlikely to do so themselves, as such action may be viewed as throwing good money after bad, especially if the preferential creditors are likely to reap the rewards. The economic arguments against the Crown's preferential status are also arguably strong. Insolvency procedures may be completed more quickly and cheaply in the absence of a requirement to set aside funds for preferential creditors. Rescue may be more likely. The government itself accepted that its status did not encourage rescue of ailing businesses, as it set up a joint body of various government agencies to co-ordinate how best to recover Crown preferential debt. More funds would be available to unsecured creditors, and banks would spend less time and energy trying to draft or operate security devices taking priority over preferential creditors. On a more basic level there is a strong instinctive argument that the Crown's preferential rights are just unfair.

The *Empirical Study* led to a number of fairly clear conclusions. Over three quarters of the respondents believed that the Crown's priority diminished the possibility of rescue. Well over half of the respondents believed the Crown had a policy of voting against rescue packages. Due to the frequently poor financial results for unsecured creditors of an insolvent liquidation, a majority of respondents felt that creditor discontent was high.

It is interesting to note that Parliament has now decided to abolish the Crown's preferential status. The suggestion made in the *Empirical Study* that Cork's 10% fund should be resurrected, has also been taken up by Parliament.

Landlords' Distress

Articles

"The Landlord, his Distress, the Insolvent Tenant and the Stranger" (2000) 16 *Insolvency Law and Practice* 47-53 (hereafter referred to as "*the Stranger*")⁷

"Landlord's Distress – Past Its Sell By Date?" [2000] Conv 508-527 (hereafter referred to as "*Sell By Date*")

Commentary

The purpose of the research on landlord's distress was to attempt to provide a reasonably comprehensive historical and doctrinal explanation of the remedy generally and how it operates in an insolvency context and, in addition, to consider its future in light of the Human Rights Act 1998.

Sell By Date is designed to give an exposition of how the remedy of distress originated and developed over the centuries. It tells the story of how in pre-Norman times the remedies available to a landlord were fairly limited and so, distress became a necessity in order to balance fairly the respective rights of the landlord and tenant. This remedy was initially subject to the jurisdiction of the courts but it soon became possible for a landlord to distrain without the formality of obtaining the consent of his own court. As time progressed, the potentially draconian power became subject to a number of statutory restrictions. Eventually the balance was perceived to have shifted too far in favour of the tenant and the landlord was then accorded further rights, most importantly the right to sell the goods distrained. This right to sell the distrained goods had an impact on third parties in that, because in theory all goods on the tenanted premises could be distrained, innocent third parties could have their goods seized and sold without even being aware of the distress. The end of the nineteenth and the early twentieth centuries saw some useful, but potentially flawed, protection for third party goods being introduced.

On top of all the piecemeal statutory amendments made over the years, a welter of case law grew up under which complex procedural rules and rules as to what goods were

⁷ V Finch *Corporate Insolvency Law Perspectives and Principles* 2002 Cambridge at 291; M Wilkins "The *pari passu* principle and human rights legislation" (2000) 16 *Insolvency Law and Practice* 93.

privileged and which were not, acted to add to the general confusion. *Sell By Date* also considered how other jurisdictions have approached the remedy of distress. Most common law jurisdictions which have inherited the remedy have abolished it either completely or at least in relation to residential leases.

At the time of drafting *Sell By Date*, no-one had hitherto considered how the Human Rights Act 1998 might affect the exercise of the remedy. This was examined and the views expressed appear to be borne out by Lightman J in *Fuller v Happy Shopper Ltd* [2001] 1 WLR 1681 at 1692 and Professor Beatson's Independent Review of Bailiff Law. It is certainly an anachronistic remedy and in the candidate's view would seem to have no place in a modern enforcement system.

The Stranger built upon the general treatment of distress and considered how the remedy operated in formal insolvency procedures. As with most rights of enforcement, it is in how it stands up when the debtor is insolvent, that one sees its true strength. Parliament has tended to perpetuate the rather illogical rules which apply to landlords' distress in the Insolvency Act. Even if one accepts that there is a case for distress as a remedy, its capacity for sidestepping the *pari passu* rule is clear. Depending upon which insolvency procedure the tenant enters, the landlord's rights may either be quite impressive or illusory. As originally drafted the provisions of the Insolvency Act contained many illogical contradictions. Despite some amendments since the publication of *the Stranger*, there remain a number of questionable distinctions. We await further developments in this area but *the Stranger* suggests that following Parliament's decision to abolish the Crown's preferential status, there is no room left for a landlord to continue to be accorded a self help remedy which often operates to defeat the *pari passu* rule.

The two articles on distress have hopefully added to the debate and highlighted a number of issues previously not fully considered elsewhere. The historical justifications for the remedy have been investigated, the discouraging complexities considered, the variable consequences in formal insolvency and the potential for attack under the Human Rights Act have been explained.

Execution Creditors

Article

"Execution Creditors – (almost) the Last Rights in Insolvency" [2003] *Common Law World Review* 179-210 (hereafter referred to as "*the Last Rights*")

Few people would argue that creditors should not be able to take security for their debts over the property of their debtors. There is clearly a lively debate as to what forms of security should be permitted and how they should operate, but in general, business activity would be made extremely difficult if lending could only be made on an unsecured basis. This is due, if nothing else, to the higher interest rates which would be payable on unsecured loans.

Arguments in favour of the Crown maintaining its preferential status are harder to come by, and have now been found by Parliament to be less than convincing. A similar point could be made of a landlord's remedy of distress. It is difficult to justify the existence of such a remedy in modern times. It is an anachronism which arguably gives landlords an unfair advantage over a debtor tenant's other unsecured creditors. Both the Crown's preferential claim and a landlord's power to distrain are the necessary incidents of the respective creditors' status. The Crown was automatically a preferential creditor (at least regarding some types of debt). Once rent is late (at least under a commercial lease) the landlord's power to distrain arises automatically. No particular step or act is required to furnish the Crown or the landlord with these special claims. A similar point could be made of a creditor with the benefit of a retention of title clause. Once the contract is entered into, the creditor will always have the power to retrieve his or her goods if the contract price is not paid.

Execution creditors are different. If an ordinary trade or other creditor is not paid, that creditor may decide to sue the debtor and obtain judgment. If the judgment is not satisfied, the creditor may then proceed to enforce the judgment by any of several modes of execution. The creditor is expending time and money in obtaining judgment and then executing it. It is arguable that this perseverance should be recognised by the courts and that such creditors deserve to be accorded some priority over other less active unsecured creditors.

There are, somewhat surprisingly, few recent commentaries on the rights of execution creditors in the UK. Apart from the significant work by Hare and Milman there has been little in depth analysis of execution creditors' claims in the event of the insolvency of the judgment debtor. The purpose of *the Last Rights* was to consider again the rights created in favour of creditors with the benefit of an execution. Of particular interest was how such rights operated in formal insolvency procedures. Since the work of Hare and Milman the new procedures of administration and voluntary arrangements have been introduced. No-one appears to have analysed how the rights of execution creditors operate in these relatively modern procedures.

The most interesting aspect of *the Last Rights* is the discussion as to what rights a creditor under a writ of *fifa* obtains and the suggestion that under the new third party debt order a creditor obtains no rights as a secured creditor.

The effect of a writ of *fifa* has long caused some confusion. The debate in the New Zealand Universities Law Review between Calnan and Blanchard highlights the problem. There is arguably authority for both the proposition that a *fifa* creditor becomes a secured creditor and authority against such a proposition. *The Last Rights* attempts to reconcile these authorities by considering the era in which such cases were decided. The main House of Lords' authority against the *fifa* creditor becoming a secured creditor was decided at a time when the courts only recognised mortgages as consensual security devices. Mortgages by definition require a transfer of title to the mortgagee. Clearly, no title vests in a *fifa* creditor upon the execution. A *fifa* creditor does have the right to ensure that the sheriff seizes and sells the debtor's goods and pays the proceeds over to

the creditor. This right is defeasible upon the payment of the debt by the judgment debtor. This bears some semblance to the classic definition of a charge. This is how the later cases in the nineteenth century characterise the rights of a *fifa* creditor. The creditor has the benefit of a charge over the seized assets but not a mortgage. The difficult case law at the end of the nineteenth and start of the twentieth centuries which attempt to explain what a floating charge is, have muddled the waters in this area.

The consequences of being a secured creditor in liquidation and bankruptcy are hardly affected by such secured status due to overriding statutory provisions. Where such status is of more significance is in the operation of voluntary arrangements and to some extent administration. Very little consideration elsewhere has been given to this matter.

The replacement of garnishee orders with third party debt orders has, it is argued in *the Last Rights*, led to a probably unintentional alteration to the execution creditor's rights. Under the garnishee scheme, despite some loose judicial phrasing, it was assumed that the execution creditor became a secured creditor. This was borne out in the wording of the relevant statutory instrument. The new statutory instrument dealing with third party debt orders has been drafted differently and it seems no longer converts the execution creditor into a secured creditor.

The main conclusion drawn in *the Last Rights* was that the current review of enforcement procedures being undertaken by the Lord Chancellor is necessary but will not solve all the problems if enforcement is looked at in a vacuum. Some sensible liaison with the Department of Trade and Industry might prove productive in introducing some level of consistency, as to what rights execution creditors have, and how these are to be viewed in an insolvency context.

Conclusion

The various investigations into the varying rights of differing types of creditors in formal insolvency procedures show the law to be a maze if not a minefield. When one considers how long insolvency laws have existed and how long different types of creditor have claimed different priority rights, it is somewhat amazing that the law should be so complex and in places left substantially unchanged for long periods of time despite obvious general dissatisfaction. Since beginning this line of research, things have begun to move in the direction of the law being clarified. Although the candidate would argue that the *Brumark* decision is *per incuriam* it does at least give some clear guidance to legal advisers as to the nature of fixed and floating charges. The Crown's preferential status is going. Landlords are likely to have their right to distrain restricted in some way. The Lord Chancellor may tidy up the rights of execution creditors. The eventual emergence of administration almost as a kind of single gateway to corporate insolvency may bring more uniformity to creditors' rights.

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21 May 2003

TO WHOM IT MAY CONCERN

I have published the following articles with Peter Walton as my co-author:

“Fixed Charges over Changing Assets – the Possession and Control Heresy” (1998) 2 *Company Financial and Insolvency Law Review* 68-87

“Book debt charges – the saga goes on” (1999) 115 *Law Quarterly Review* 14-17

“Book Debt Charges: Following *Yorkshire Woolcombers* – Are We Sheep Gone Astray?” [2000] *Insolvency Lawyer* 157- 168

“Fixed and Floating Charges – A Revelation” [2001] *Lloyds Maritime and Commercial Law Quarterly* 123-149.

I confirm that Mr Walton was fully involved in every aspect of the research, analysis and writing of these articles. His contribution to the articles was equal to mine in all respects.

A handwritten signature in black ink that reads "Roger M Gregory". The signature is written in a cursive, flowing style. Below the signature, there is a long, horizontal, slightly wavy line that extends across the width of the signature.

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TO WHOM IT MAY CONCERN

19 May 2002

In 1999 I had two articles published, namely :

- “Preferential Debts : An Empirical Study” [1999] *Insolvency Lawyer* 112-118 and
- “The Preferential Debts’ Regime in Liquidation Law : In the Public Interest?” (1999) 3 *Company Financial and Insolvency Law Review* 84-105

My co-author in the writing of the articles was Peter Walton.

I confirm that in relation to these articles, Peter was involved in the formulating of the research topics, the conducting of the research, the analysis of data, and the writing of the articles. His contribution to the articles was equal to mine in all aspects.

A handwritten signature in black ink, appearing to read "A Keay".

Professor Andrew Keay

Professor of Corporate and Commercial Law
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FIXED CHARGES OVER CHANGING ASSETS—THE POSSESSION AND CONTROL HERESY

Roger Gregory and Peter Walton†*

INTRODUCTION

Nearly twenty years of banking practice and thematic judicial exposition following upon *Siebe Gorman and Co Ltd v Barclays Bank Ltd*¹ have failed to harmonise modern discord over the fixed charge on debts or other personal property—if anything the *sturm und drang* is intensifying. For example, the Auditor and Comptroller General feels that receivers have wrongly treated floating charges as fixed and wants something done about it;² Dr Gough considers that a fixed charge over personalty with an implied power in the chargor to deal with the security is a conceptual impossibility;³ the Court of Appeal's judgments in *Royal Trust Bank v National Westminster Bank Plc*⁴ present a picture of the utmost confusion; and in *Whitton v ACN*⁵ in New South Wales Bryson J expressly refused to follow the approach in *Re Brightlife Ltd*⁶ as being incompatible with Romer LJ's third characteristic of a floating charge in *Re Yorkshire Woolcombers Association Ltd*.⁷

Notwithstanding these difficulties, many company lawyers would settle for the following passage from McCarthy J's judgment (quoting the court below) in *Re Keenan Bros Ltd*.⁸

"I think that one has to bear in mind at the outset that this form of charge [the floating charge] made its first appearance in England as a by-product of the joint stock companies which began to flourish after the enactment of the Joint Stock Companies Act 1844. In order to borrow money, such companies offered as security not merely their fixed assets, but also assets which are regularly turned over in the course of business such as the companies' stock-in-trade. It was obviously cumbersome and impractical to charge such assets specifically with the repayment of advances, since it would mean the constant execution and release of securities as the assets were disposed of and replaced. Hence the concept developed of a charge which did not attach to any specific assets of the company, remained dormant until the mortgagee intervened and in the interim did not prevent the mortgagor from using the assets in question in the ordinary course of his business."

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¹ [1979] 2 Lloyd's Rep 142.

² HC 695 Session 1995–96.

³ Gough, *Company Charges*, 2nd ed (Butterworths, London, 1996), (hereafter "*Gough*"), 368.

⁴ [1996] 2 BCLC 682.

⁵ (1996) 14 ACLC 1799, 1810–1814.

⁶ [1987] Ch 200.

⁷ [1903] 2 Ch 284, 295.

⁸ (1986) 2 BCC 98, 970, 98,974–98,975, quoting Keane J.

The judicial approach is strongly underpinned by Professor Pennington's influential article, "The Genesis of the Floating Charge,"⁹ in which he traces the refusal of the Common Law to accept anything like the Roman *hypotheca* and analyses *Holroyd v Marshall*¹⁰ in 1862 as "the first leading case in which equity intervened to remedy the defects of the common law . . . in which the mortgage created what was later identified as a floating charge, although it was too early at that date for the court to recognise it as such".¹¹ In a later section of his article¹² Professor Pennington argues that after 1862, when *Holroyd* made the floating charge a possibility, decisions on statutory company mortgages and on shareholders' liability on insurance claims pointed a way forward which draftsmen promptly appreciated because in the 1860s security documents granting such charges began to appear. The break, in Professor Pennington's view, came with *Re Panama, New Zealand, and Australia Royal Mail Co*¹³ in 1870.

In his leading work *Company Charges*¹⁴ Gough says:

"Conceptually speaking a specific charge with an implied licence is an impossibility. It is conceptually impossible to postulate the existence of a specific charge and at the same time permit the chargor, without need for express consent from the chargee with regard to specific property, to dispose of that specific property in the ordinary course of business".

Most, if not all, law graduates who read the company law syllabus learned the elements of a floating charge as part of it. One can understand the theorising potential of the seeming coincidence that, in substance at least, the floating charge started life in 1862, the year of the first real Companies Act. Hence there is a belief, hallowed by repetition, that *hypotheca* (with "*Holroyd v Marshall*" woven into her damask) stepped, Venus-like, fully-formed from the sea, tripped on a submerged boulder or two¹⁵ and finally landed on the beach to distribute copies of *Panama* to a shocked, surprised and delighted legal profession.

The allusion to mythology (albeit classical) is not accidental. The idea that *Holroyd* was some bright new thing consciously reared by company lawyers to become the intellectual beauty known as the floating charge is, in the authors' view, every bit as mythical as Venus but not nearly as alluring.

Holroyd marked the end of an ancient dispute (or, even, feud) between common law courts and equity courts over bills of sale. Each side held fixed views, more or less resolutely stuck to them¹⁶ and carried on so doing for centuries. It is not proposed to trace the history of this altercation here—it has already been fully documented by *H W May*¹⁷,

⁹ (1960) 23 MLR 630.

¹⁰ (1862) 10 HLC 191; 11 ER 999.

¹¹ Pennington (1960) 23 MLR 630, 634.

¹² *Ibid*, 642–644 (section entitled "The Consummation").

¹³ (1870) 5 Ch App 318.

¹⁴ *Gough*, 368.

¹⁵ *King v Marshall* (1864) 33 Beav 565; 55 ER 488; *Re Marine Mansions* (1867) LR 4 Eq 601; *Stanley's case* (1864) 4 de G J and S 407; 46 ER 976.

¹⁶ In *Twyne's Case* (1601) 3 Co Rep 80(a); 76 ER 809 (Star Chamber), the fifth resolution of the court was: "here was a trust between the parties for the donor possessed all, and used them as his proper goods, and fraud is always apparelled and clad with a trust, and a trust is the cover of fraud." By 1788 Buller J relented sufficiently from his forefathers' approach to accept that the trust or charge appearing on the face of the instrument in *Bucknal v Roiston* (1709) Prec in Ch 285; 24 ER 136 did not constitute a fraud: *Edwards v Harben* (1788) 2 TR 587; 100 ER 315.

¹⁷ *The Law of Fraudulent and Voluntary Conveyances*, 3rd ed (Steven and Haynes, London, 1908) (hereinafter "*H W May*").

*Kerr*¹⁸ and *Powell*.¹⁹ Those who take a too strong view of Professor Pennington's description of *Holroyd* as the "first leading case" should read his very good article in 1985²⁰ where he recalls the ways in which equity distanced itself from the common law from the end of the seventeenth century.

It is necessary, however, to refer to some of the salient features of the two courts' dispute.

Common law

The indivisibility of ownership and benefits such as possession is one of the great bedrocks of common law thinking²¹ and originates with its view of seisin as an essential component of ownership. Seisin was not just a land law notion; it applied to personal property as well. Thus in 1275 a manorial court²² considered the liability in trespass of Richard le Bocher, who was "*in seysina*" of a woollen fleece and a pig's ham as a result of a bit of (rough) market trading not far from Cambridge. A number of consequences flowed from this approach:

(a) Remedies for trespass, detinue, ejectment, conversion *etc* were available only to plaintiffs who could demonstrate possession, actual or legal, or at least an immediate entitlement thereto.

(b) Generally there could be no title without possession or control. A mortgage of future property, therefore, did not vest any title in such property until by some *novus actus* the mortgagee had reduced the property into his possession or control.²³

(c) Some wickedness had stemmed from the splitting of ownership and possession; and the common lawyers had had their dislike enshrined in statute in a number of circumstances. For example, the Statute against Fraudulent Deeds by Debtors 1379 prevented persons from transferring their property by deed to a third party, going into sanctuary and living on credit thereafter, knowing that their persons were immune from process and that the transferred property was safe because the transferee was not indebted. Another example was the Statute of Frauds 1571, which sought to outlaw transactions under which title passed but not possession and the "use" was singled out for dishonourable mention. The "order and disposition" provisions in the Bankruptcy Acts only disappeared with the Insolvency Acts 1985–1986, following recommendation by the Cork Committee.²⁴

What the common lawyers disliked about the splitting of ownership and possession was the creation of a delusive credit by traders who transferred their property to a third party

¹⁸ S E Williams (ed), *Kerr on Fraud and Mistake*, 5th ed (Sweet and Maxwell, London, 1920) (hereinafter "*Kerr*").

¹⁹ T Coventry (ed), JJ Powell, *A Treatise on the Law of Mortgages*, 6th ed (1826) vol 2, ch 2 (hereafter "*Powell*").

²⁰ R Pennington, "Fixed Charges over Future Assets of a Company" (1985) 6 Co Law 9.

²¹ See H Bracton, "de Acquirendo Rerum Dominio", *Bracton on the Laws and Customs of England*, 300.

²² *Select Pleas in Manorial Courts* 2 Selden Society (1882), 142–143.

²³ Founding authority for this proposition is generally taken to be Bacon's *Maxims Reg* 14, cited in *Holroyd v Marshall* (1862) 10 HLC 191, 195. Cases exemplifying the maxim are cited *ibid*, 197–200.

²⁴ *Report of the Review Committee on Insolvency Law and Practice* (1982) Cmd 8558. In ch 23 of its Report the Committee noted that in commercial practice visible assets were no longer an indicator of creditworthiness.

by bill of sale but carried on in business as though owners, trading with the property. Bills of sale, being secret, then destroyed what would otherwise have been a prospect of distribution in bankruptcy.

Equity

The stance of equity was almost entirely opposed to that outlined above. Equitable remedies were superior in the sense that they could be invoked without proof of possession. Mortgages of future property were effective as soon as property fitting the description came into the hands of the mortgagor—no *novus actus* was needed. Equity also moulded its rules to promote trade. In particular it recognised that raising money on security was vital to trade and that the only way to pay off borrowed money was to continue trading. It was quite unfussed, therefore, about the idea that mortgaged property could be left in the possession of the mortgagor to be used by him in the operation of trade to repay the loan.

Both sides had a point—delusive credit was a fraud; on the other hand, trade finance needed present and future property as security *and* the trader to continue in order to repay.

This was the dispute which *Holroyd* finally ended. In this case a chargee whose security extended to “machinery implements and things” fixed in or placed about a mill and future items of that description prevailed over an execution creditor in respect of after-acquired machinery following seizure and sale by the sheriff. It is worth reading the report of the argument in the law report.^{24A} The execution creditor relied on the common law principles of possession and *novus actus* and the chargee urged the equity principles, which did not require possession and *novus actus* but were, rather, that the equitable interest was complete, and its priority established, as soon as property covered by the terms of the bill of sale came into the chargor’s hands.

Whilst the judgments applied equity doctrines, Lord Westbury tied the mortgagee’s equitable interest to the right to obtain specific performance (as opposed to the maxim equity looks upon that as done which ought to be done). In *Tailby v Official Receiver*²⁵ the House of Lords was not sure whether Lord Westbury was seeking “to guide or perplex”^{25A} later courts and settled that the equitable interest arises from the maxim.

EQUITABLE SECURITY AND TRADE FINANCING

Whereas many discussions of fixed and floating charges concentrate heavily on the post-*Holroyd* era, there is a question of how trade was financed before 1862 and what sort of security arrangements were put in place. What follows is taken from judgments on bills of sale in three cases of 1758, 1804 and 1857, which, treating three years early in 1804 as the merest scintilla, mark the beginning, middle and end of a one hundred year period.

^{24A} (1862) 10 HLC 191, 195–209.

²⁵ (1888) 13 App Cas 523.

^{25A} *Ibid*, 547, *per* Lord Macnaghten.

The first case is *Worsley v Demattos*.²⁶ A bill of sale by way of mortgage was given by a corn miller and factor to his banker. By the bill the miller “grants, etc all his stock, utensils, and other things used in his trades of brewing and malting, and of a cornfactor and miller; consisting of coppers, tuns, backs, coolers, pumps, cisterns, screens and other implements; and *also all his changeable stock, consisting of debts*, horses, carts, casks, hops, beer, ale, wheat, barley, malt, coals, wood and all other goods and commodities belonging, employed, or made use of, in the said several trades, or any of them”.^{26A} As Lord Mansfield said of the document:^{26B} “By the express tenor of the deed, Slader [the miller] was to have the absolute order and disposition as before. In fact he was permitted to continue in possession, and act as owner. They who dealt with him trusted to his visible trade and stock”.

The second case is *Nutbrown v Thornton*.²⁷ The bill of sale is not set out in any detail. Lord Eldon refers to it as an “assignment of all the cattle, stock and personal estate; and the landlord was at liberty to enter and sell all this in the event provided”. The transaction here involved a lease of a farm for seven years and another transaction, a bill of sale, under which the tenant was advanced £500 by the landlord to enable him to cultivate the farm. It was envisaged that the loan might go on for seven years and allowed for other credit to be taken up with the landlord. If the debt exceeded £500 at any time, the landlord could enforce his security.

The third case is *Weaver v Joule*,²⁸ in which Blainey, a brewer, executed a bill of sale as a mortgage of all his “household furniture, stock in trade, brewing implements, linen, glass, earthenware, metalware, cart, harness, pig and all other goods, chattels and effects whatsoever belonging to him . . . except and reserved, nevertheless unto [Blainey] so long as he shall continue to pay off the said sum . . . the free use possession and enjoyment of the said personal estate and effects hereby assigned . . .” According to the report, “Blainey remained in possession of the goods assigned, and to all appearance carried on the business of a retail brewer as though no such assignment had ever been made”.^{28A}

The main interest of *Worsley* and *Weaver* is that, notwithstanding their dates, they adopt a structure which appears to be common form having regard to the law reports of cases cited by *H W May, Kerr, Powell and Christian*.²⁹

The main difference between *Worsley* and *Weaver* is that the former does not, in the report at least, expressly leave the property in the “use, possession and enjoyment” of the borrower, unlike *Weaver*. In this context Lord Eldon’s judgment in *Nutbrown* is quite illuminating on the effect of absence of any express power to deal where goods were assigned. He noted that “first it made it impossible that the tenant should remove any cattle from the premises; though the terms require that he should be a cattle dealer”.³⁰ The Lord Chancellor held that the whole point of the agreement was that the tenant should have the enjoyment of the farm for the purposes of agriculture and expressly refused, therefore, to allow the landlord assignee to take property forming his security until the seven year lease

²⁶ (1758) 1 Burr 467; 97 ER 407.

^{26A} Emphasis added.

^{26B} (1758) 1 Burr 467, 475.

²⁷ (1804) 10 Ves Jun 159; 32 ER 805.

²⁸ (1857) 3 CB (NS) 309; 140 ER 759. The reference to “effects” in the bill in this case was usual. “Effects” was taken to include stock in trade in *Re American Leather Cloth Co* (1879) 42 LT 504, 43 LT 43.

^{28A} (1857) 3 CB(NS) 309, 316–317.

²⁹ Christian, *Present Practise in the Law of Bankrupts*, 2nd ed (1818).

³⁰ (1804) 10 Ves Jun 159, 161.

ended (or the debt exceeded £500), leaving the tenant assignor free to carry on business with the stock, crops and cattle, saying:³¹ “The circumstance of a trust by way of deposit, as in *Fells v Read*,^[32] is not required in this instance, to furnish the principle upon which the Court might be required to interpose”. Effectively the lease and the bill of sale were read together to ascertain the nature and purpose of the agreement.

In giving effect to assignments or mortgages of the whole of a trader’s assets, equity gave effect to the business nature of the contract. As Erle J said in *Bittlestone v Cooke*:³³ “There often may be a very good reason for taking a security over the whole of a trader’s stock present and future, as then the stock may be used in the meantime and made a source of profit, whilst, if a portion of the existing stock is separated and set aside as a security, it is tied up from use”. In *Hutton v Cruttwell*³⁴ in 1852, where a hotel keeper assigned all present and future chattels, Lord Campbell C J described the circumstance as “the common case of a bill of sale bona fide given to secure an advance on the faith of the security to enable a trader to carry on his business”.

In a shipping case of 1709³⁵ security over the cargo of a vessel about to embark upon a trading voyage extended to the “produce and advantage” that might be made thereof and no doubt the scale of such trading would be quite extensive. Similarly the mortgagor of a ship’s future freight had the exclusive management of the vessel and its voyages.³⁶

Any trawl through the law reports from the early eighteenth century onwards into the late nineteenth century shows that, in the financing of trade, bills of sale giving specific security over all the present and future chattels of a trader became a standard mechanism employed by those who supplied the capital.³⁷

The cases were numerous largely because mortgagees or assignees under bills of sale sought to defend them against a wide range of attacks. The most frequent examples are:

³¹ *ibid*, 161.

³² (1796) 3 Ves 70; 30 ER 899.

³³ (1856) 6 El and Bl 296 (119 ER 875), 310. See also *ibid per* Lord Campbell.

³⁴ (1852) 22 LJQB 78, 80.

³⁵ *Bucknal v Roiston* (1709) Prec in Ch 285; 24 ER 136; *Curtis v Aubur* (1820) 1 Jac & W 526; 37 ER 468; *Langton v Horton* (1842) 1 Hare 549; 66 ER 1149.

³⁶ *Davenport v Whitmore* (1836) 2 My & Cr 521; *Douglas v Russell* (1831) 4 Sim and Stu 524; *The Ship Warre* (1817) 8 Price 271 (see the contrasting approach of the common law court in the same case reported *Robinson v MacDonnell* (1816) 5 M & S 228); *Leslie v Guthrie* (1835) 1 Bing NC 697.

³⁷ A representative sample of cases is as follows: *Ryall v Rolle* (1749) 1 Atk 165; *Worsley v Demattos* (1758) 1 Burr 467; *Lunn v Thornton* (1845) 1 CB 379; 135 ER 587; *Re Langmead’s Trusts* (1855) 20 Beav 20 (52 ER 509); *Reeve v Whitmore* (1863) 33 LJ Ch 63; *Belding v Read* (1865) 13 LT (NS) 66; *Holroyd v Marshall* (1862) 10 HLC 191; *Mercer v Peterson* (1867) LR 2 Ex 304 and (1868) LR 3 Ex 104; *Lomax v Buxton* (1871) LR 6 CP 107; *Thompson v Cohen* (1872) LR 7 QB 527; *Greenbirt v Smea* (1876) 35 LT (NS) 168 (badly drafted, ended as all present property, but trade continued); *National Mercantile Bank Ltd v Hampson* (1880) 5 QBD 177; *Walker v Clay* (1880) 49 LJQB 560; *Taylor v McKeand* (1880) 49 LJQB 563; *Payne v Fern* (1881) 6 QBD 620; *Clements v Matthews* (1883) 11 QBD 808; *Joseph v Lyons* (1884) 15 QBD 280. Sometimes the bill expressly left the goods in the possession or possession and use or possession use and enjoyment: eg *Hutton v Cruttwell* (1852) 22 LJQB 78; *Harris v Rickett* (1859) 28 LJ Ex 197; *Weaver v Joule* (1857) 3 CB (NS) 309; 140 ER 759. Some bills covering all machinery plant and stock were expressed to cover substitutions, renewals and additions: *Congreve v Evetts* (1854) 23 LJ Ex 273; *Leathem v Amor* (1878) 47 LJ QB 581; *Lazarus v Andrade* (1880) 5 CPD 318. See also the precedents in D B Wilson, *Law and Practice under the Bills of Sale Act 1878*, 2nd ed (Horace Cox, London, 1881), 98–100, and in FCJ Millar, *Bills of Sale*, 4th ed (Stevens and Sons, London 1877), 348. There is a short interesting discussion on compliance by companies with the Bills of Sale Act 1854 (to which companies were subject) in FB Palmer, *Company Precedents*, 1st ed (London, 1877), 404–410; see also the precedents *ibid*, 435, 438.

(a) *The order and disposition clauses in bankruptcy*

In *Longman v Tripp*³⁸ the editor of the *Bristol Mercury* assigned his interest in the newspaper to the plaintiffs as security for advances. He continued to manage the newspaper's business and on his subsequent bankruptcy his estate successfully claimed the business under the order and disposition clause. Charges over debts and other choses in action were also within the clause. Lord Eldon held in *Jones v Gibbon*³⁹ that escape from the clause required that notice be given to the principal debtors by the mortgagee.

(b) *Fraudulent conveyances as acts of bankruptcy*

In *Worsley v Demattos*,^{39A} referred to earlier, the assignment of all the miller's stock and assets present and future under the bill was expressed to be in consideration of 5 shillings. The banker assignee's argument that he was to support the miller in future dealings did not save the bill from being an act of bankruptcy.

(c) *The Statute of Frauds*

Whilst *Twyne's Case*^{39B} of 1601 reigned, a transfer of property by bill of sale which left possession in the transferor was struck down as a fraud at Law. It was this point upon which equity opposed the common law courts on the ground that if the possession was consistent with the terms of the bill of sale itself there was no fraud (*Bucknal v Roiston*).^{39C}

(d) *Subsequent purchasers*

The bill of sale holder could challenge a sale by the mortgagor if not effected in the ordinary course of business (see *Payne v Fern*⁴⁰ where the jury found that the mortgagor's sale was not in the ordinary course of business).

(e) *Judgment creditors*

Holroyd v Marshall was a case of competition between a bill of sale holder and a judgment creditor following seizure by the sheriff.

Whether or not Jessel MR's remarks⁴¹ in the late 1870s that a charge over the undertaking would "paralyse" the business upset bills of sale financiers is not clear, but it is interesting that in a small group of cases the courts felt constrained (here in Lindley J's words) to say of bills over all present and future chattels:⁴² "The object of the bill of sale is obviously not to paralyse the trade of the grantor, but to enable him to carry on his trade, and the bill would be worthless if we were to construe it otherwise . . . I think, therefore, that the covenant not to remove is a covenant that the grantor will not remove or dispose of the goods otherwise than in the ordinary course of his trade". Moreover, the consequence of the mortgage relationship was not to make the mortgagor agent of the mortgagee to realise the security.⁴³

³⁸ (1805) 2 Bos & Pul (NR) 67; 126 ER 547.

³⁹ (1800) 1 Ves 461.

^{39A} (1758) 1 Burr 467.

^{39B} (1601) 3 Co Rep 80(a).

^{39C} (1709) Prec Ch 285.

⁴⁰ (1881) 6 QBD 620.

⁴¹ *Re Florence Land* (1878) 10 Ch D 530, 541. He was not alone in saying this of a charge on the "undertaking".

⁴² *Walker v Clay* (1880) 49 LJQB 560, 561. The other cases were *Taylor v McKeand* (1880) 49 LJQB 563; *National Mercantile Bank v Hampson* (1880) 5 QBD 177 and *Payne v Fern* (1881) 6 QBD 620.

⁴³ *Joseph v Lyons* (1884) 15 QBD 280.

As far as equity was concerned, if an express power to deal with the subject matter of security over all present and future chattels was given to the borrower, it was effective; and, if it was not expressly given, it was implied. This was the position between 1709 and 1881.

WHY DID THE FLOATING CHARGE TAKE OFF?

The obvious inference from the fact that specific security with a power to deal was an everyday financing mechanism is that the floating charge would be otiose. The banks had all the security and powers they needed to finance and facilitate trade. So what happened?

Bills of sale developments

The answer lies in the general wisdom of Parliament and in particular the Bills of Sale Act (1878) Amendment Act of 1882. The Bills of Sale Act 1878 removed bills of sale from the operation of the reputed ownership provisions of the Bankruptcy Act 1869 and, following opposition, Parliament intervened again to restore the position in the 1882 Act.

Parliamentary activity this time, however, was not limited to restoring the Bankruptcy Act position. By a sweeping reform, security bills of sale had to be as nearly as possible in line with the statutory model form⁴⁴ and this model did not allow for security over future chattels. Overnight it became extremely difficult, if not impossible, for the banks to take security over present and future trade personalty which would be effective against third parties. Priority over third parties was essential.

Whilst companies, as such, were not taken out of the operation of the Bills of Sale etc Act 1882 there was an important exception made in s 17 for “any debentures” “issued” by any “mortgage, loan, or other incorporated company” and “secured upon the capital stock or goods, chattels, and effects of such company”.

Initially the interpretation put upon s 17 was catastrophic for the banks. In 1884 in *Brocklehurst v Railway Printing and Publishing Co*⁴⁵ the security was taken out with trustees for the debenture holders, whom the company did not covenant to repay; and in the separate debenture holders’ agreement (where repayment was offered) there was reference to security but the security given to the trustees was not specifically identified in the contract. In that state of affairs the court held that (i) the document was not a debenture; (ii) the security amounted to bill of sale and was, therefore, void for non-registration; and (iii) (most crucially) the words “other incorporated company” in s 17 had to be construed *eiusdem generis* with “mortgage” and “loan” and did not, therefore, cover the generality of companies formed under the Companies Acts.

This decision caused immediate consternation. Within two years the court in *Ross v Army and Navy Hotel*⁴⁶ was considering the state of a company’s debenture instruments which had been reworked specifically to avoid the decision in *Brocklehurst*. In the event the Court of Appeal there held that the original documents (and not the additional ones)

⁴⁴ Bills of Sale Act (1878) amendment Act 1882, s 9. Future property was excluded by s 5.

⁴⁵ [1884] WN 70.

⁴⁶ (1886) 34 Ch D 43 (CA).

were effective, distinguished *Brocklehurst*, and said soothing things about the word “debenture”.

It was, however, not sufficient and in *Jenkinson v Brandley Mining Co*⁴⁷ the Common Lawyers went back to *Brocklehurst* for inspiration. Grove J distinguished *Ross*, saying that “the question in that case was merely one between the debenture holders and the company itself” and that it was “no authority whatever against a bona fide creditor for value who has issued execution against the company; if it were, a company would be enabled to entirely evade all the *wholesome requirements* of the Bills of Sale Acts . . .”.^{47A} The judge thought that a company which wanted to avoid paying debts would only have to issue debentures and get the holders to set up their claims, which would be a “manifest injustice”. The old feud thus carried on; *Holroyd v Marshall* might have stopped the war but not all the common lawyers had rushed out to kiss and make it up with *hypotheca*.

In 1887, in the preface to the fifth edition of his book, H Burton Buckley reported⁴⁸ that, as far as companies legislation was concerned, since his fourth edition statutory alterations were few and unimportant. In his second paragraph he says:

“A statutory alteration of some moment is, however, contained in the Bills of Sale Act 1882: an Act which renders the policy of the Bills of Sale Acts applicable to securities given by Joint Stock Companies, subject to exception provided by s 17 of that Act. The difficult wording of that section cannot but occasion litigation. Two or three cases have already been decided upon it”.

In his text⁴⁹ he notes that “many difficult questions arise upon this difficult section in a difficult Act and not many have yet been decided” and asks whether “any debenture” can be given to one person or must be “issued” to several, whether the *eiusdem generis* rule should apply to “other incorporated company” and whether security over part only of the chattels would satisfy the wording of s 17 (this last point was left open in *Ross v Army and Navy Hotel*^{49A}).

Lindley on Companies in 1889⁵⁰ simply notes that a company can give a bill of sale which will be within the Bills of Sale Acts unless s 17 applies—citing *Shears v Jacob*,⁵¹ *Deffell v White*,⁵² *Attenborough's Case*,⁵³ the awkward decision of *Jenkinson v Brandley Mining*^{53A} as well as *Ross v Army and Navy*.

As far as the banking world was concerned, taking security over present and future property had been the cornerstone of the trade financing system. Security was a *sine qua non* of lending and the power to deal was a *sine qua non* of that security because only by continuing to trade could the borrower get into a position to pay off the debt. The whole point of the system was to facilitate trade—not stop it. Suddenly the Bills of Sale legislation of 1882 had jeopardised the whole thing.

⁴⁷ (1887) 19 QBD 568.

^{47A} *Ibid*, 571 (emphasis added).

⁴⁸ *Buckley on the Companies Acts*, 5th ed, (London, 1887).

⁴⁹ *Ibid*, 158–160.

^{49A} (1886) 34 Ch D 43.

⁵⁰ 5th ed (London, 1889), 202–203.

⁵¹ (1866) LR 1 CP 513.

⁵² (1866) LR 2 CP 144.

⁵³ (1885) 28 Ch D 682.

^{53A} (1887) 19 QBD 568.

Charges over the undertaking

A few years before 1882 and, therefore, for reasons wholly unconnected with the Bills of Sale Acts, the Chancery courts had been entertaining actions in respect of a species of charge whose wording had started to be used by companies formed under the Companies Act, though borrowed from another source.

It is widely accepted that *Re Panama, New Zealand and Australian Royal Mail Co*⁵⁴ is the first instance where the courts recognised the type of security which later became known as the floating charge. This invention of equity was the culmination of a small line of cases⁵⁵ where the courts experienced difficulty in interpreting the meaning of a charge given over the “undertaking” of a company registered under the Companies Acts.

Mortgages over a company’s “undertaking” first appeared at the end of the eighteenth century during the Industrial Revolution.⁵⁶ Companies were incorporated under private Acts of Parliament and were given statutory authority to engage in large-scale public utility projects requiring powers of compulsory acquisition such as the construction and running of canals, railways, water and gas works.

Commonly a railway company set up in this way had the power to raise large sums by inviting the public to subscribe for shares and to borrow large amounts by issuing mortgage debentures secured on the company’s undertaking, tolls and profits. As the incorporation of such companies became more common, the Companies Clauses Consolidation Act 1845 was passed, which contained provisions of general application to such companies and which could be incorporated by reference into the Act creating any new utility company.⁵⁷ Section 41 of the Act stated that any mortgage created by the company must be in the form given in Schedule C to the Act. Schedule C provided for the company to assign “the said Undertaking [and (*in case such Loan shall be in anticipation of the Capital authorized to be raised*) all future Calls on Shareholders], and all the Tolls and Sums of Money arising by virtue of the said Act, and all the Estate, Right, Title and Interest of the Company in the same . . .” The meaning of undertaking is rather unhelpfully defined in s. 2 as “the undertaking or works, of whatever nature, which shall by the special Act be authorised to be executed”.

As there was no legislative history to guide the courts as to the meaning of “undertaking” in this context, when the matter came up for consideration, as it did several times in the mid-nineteenth century, it initially led to some decisions which were not all readily reconcilable.⁵⁸ When considering the meaning of the term “undertaking” the courts were swayed by the public policy reasons behind the companies’ existence. Sir John Romilly MR in a railway case stated:⁵⁹

⁵⁴ (1870) 5 Ch App 318.

⁵⁵ See *King v Marshall* (1864) 33 Beav 565; 55 ER 488, *Re Marine Mansions Co* (1867) LR 4 Eq 601 and *Re New Clydach Sheet and Bar Iron Co* (1868) LR 6 Eq 514.

⁵⁶ See eg *Hopkins v Worcester and Birmingham Canal Proprietors* (1868) LR 6 Eq 437, where a canal company was set up in 1791 by a statute giving the company power to raise money by way of mortgaging its undertaking.

⁵⁷ The 1845 Act was supplemented by a similar Act of the same year for Scottish statutory companies and by other Acts of the same and subsequent years dealing with specific types of utility.

⁵⁸ See generally Chantal Stebbings, “Statutory Railway Mortgage Debentures and the Courts in the Nineteenth Century” (1987) 8 J Legal Hist 36.

⁵⁹ *Furness v Caterham Railway Co* (1859) 27 Beav 358 at 361; 54 ER 140.

"All I understand by the decisions of the Court on the word 'undertaking' is, that it is the right to use land for the purposes of conveying passengers and making profits by the tolls, that the debenture-holders cannot take possession of the land and use it so as to put a stop to the undertaking, and that mortgages of the undertaking do not enable the mortgagees to put an end to it".

The suggestion that a mortgagee might take possession of the land upon which the railway operated and thereby put an end to the undertaking was described by Coleridge J as "a very monstrous and improbable supposition".⁶⁰

The mortgage of the undertaking contemplated a repayment of money consistently with and by means of a carrying on of the undertaking. In the leading case of *Gardner v London, Chatham and Dover Railway Co*,⁶¹ Cairns LJ explained the meaning of undertaking as:

"the proper style, not for the ingredients, but for the completed work, and it is from the completed work that any return of monies or earnings can arise. . . . [T]he undertaking . . . is . . . made over . . . as a going concern, with internal and Parliamentary powers of management not to be interfered with; as a fruit-bearing tree, the produce of which is the fund dedicated by the contract to secure and to pay the debt. The living and going concern thus created by the Legislature must not, under a contract pledging it as security, be destroyed, broken up, or annihilated."

Although the wording of the Schedule C security suggests that the mortgagee would on default by the company be entitled to force a sale of the company's assets, the courts regarded the public nature of the undertaking to be of paramount importance and so they limited the mortgagee's rights to enforce his security. Whilst the company was a going concern, the mortgagee was not entitled to an order for sale of any or all of the company's assets. "Undertaking" was taken to mean that the company would continue to provide its services to the public. The courts did not allow the destruction of the public utility which Parliament had intended to continue in perpetuity. Whilst the company was a going concern the mortgagee's only remedy was to ask the court for the appointment of a receiver of the net earnings of the undertaking.⁶² The security did give the mortgage holder a priority over judgment creditors. The courts would usually grant injunctions against judgment creditors who attempted to levy execution against the company's assets.⁶³

Although the mortgage holder had no right of foreclosure or sale whilst the company was a going concern, once the company had sold the undertaking⁶⁴ or been wound up⁶⁵ the mortgagee's rights could be enforced against the proceeds. The mortgage of the undertaking was, therefore, a security over all the assets of the company used in its business but the mortgagee could only enforce the security against such assets once the company had

⁶⁰ *Doe d Myatt v St Helen's and Runcorn Gap Railway Co* (1841) 2 QB 364.

⁶¹ (1867) 2 Ch App 201, 217.

⁶² *Great Eastern Railway Co v East London Railway* (1881) 44 LT 903. The mortgagee also had the right common to all creditors of the company to levy execution against the company's assets: see the Companies Clauses Consolidation Act 1845, s 36 and *Russell v East Anglian Railway Co* (1850) 3 Mac & G 104, 143-147 (42 ER 201).

⁶³ *Legg v Mathieson* (1860) 2 Giff 71; *Wildy v Mid-Hants Railway Co* (1868) 18 LT 73. Cf *Russell v East Anglian Railway Co* (1850) 3 Mac & G 104; 42 ER 201.

⁶⁴ *Furness v Caterham Railway Co* (1859) 27 Beav 358; 54 ER 140; *Re Woking Urban Council (Basingstoke Canal) Act 1911* [1914] 1 Ch 300, 314.

⁶⁵ *Re Glyn Valley Tramway Co* [1937] 1 Ch 465.

ceased to be a going concern. The restrictions on remedies available to the mortgagee lasted only as long as public policy demanded that the company's undertaking be protected.

The crucial point made consistently by the courts is that the mortgage of the undertaking of a statutory company is quite different from a normal mortgage. Lord Truro LC⁶⁶ emphasises that the statutory form does not give rise to a "specific equitable lien" upon the estate and effects generally of the company or on "every spade or barrow which the company may possess". To permit this type of interpretation would permit the mortgagees at any time to assert their "lien" on the company's assets at the expense of the company's general creditors who had provided credit to the company on the strength of its apparently unfettered ownership of such assets. In the view of Lord Truro this would amount to a fraud.

A similar sentiment was expressed by Cairns LJ:⁶⁷

"The assignment made by the mortgage debentures is immediate, and is to continue for three years at the least. If the debenture holders are right in their argument, they became immediate assignees in specie of all the ingredients which I have enumerated as going to make up the undertaking, and they might, from the first, have asserted their rights as mortgagees by taking and impounding not merely the proceeds of surplus lands, but the capital, the cash balances, the rolling stock, and even their own money advanced."

Both their lordships dismissed such suggestions as being contrary to the intention of Parliament. If the debenture holders' arguments were to succeed, the maintenance and operation of these companies for the public good could be frustrated at the whim of the mortgagee.

Whilst the courts developed the meaning of "undertaking" as it related to the statutory company mortgages, Parliament introduced in 1844 the possibility of trading as a company registered under the Companies Act,⁶⁸ although only limited use was made of this business medium until after the reforms put in place by the Limited Liability Act 1855 and Joint Stock Companies Act 1856.⁶⁹

It seems that from these early days draftsmen of secured loans to registered companies looked to the statutory precedent for guidance.⁷⁰ Indeed it would have been surprising if this had not been the case. Early modern company law, therefore, saw the adoption of a mortgage (or "charges" to avoid the provisions of Bills of Sale Act 1854) of a company's undertaking. The first reported instance is *King v Marshall*,⁷¹ where the charge was executed in 1859. The company was in insolvent liquidation and the issue before the court was whether uncalled capital came within the meaning of "undertaking". Sir John Romilly MR adopted the statutory definition of "undertaking" and held that the uncalled capital fell outside the term. Uncalled capital was just one species of debt owed to the company. If a company charged its debts, it could not carry on its business nor could it

⁶⁶ *Russell v East Anglian Railway Co* (1850) 3 Mac & G 104, 143, 146.

⁶⁷ *Gardner v London, Chatham and Dover Railway Co* (1867) 2 Ch App 201, 217.

⁶⁸ Joint Stock Companies Act 1844.

⁶⁹ See *Farrar's Company Law*, 3rd ed (Butterworths, London, 1991), 20.

⁷⁰ See Edward Manson "The Growth of the Debenture" (1897) 13 LQR 418, 420, where the writer suggests that the form of a series of debentures issued by a registered company secured on its undertaking was based upon the series of concurrent mortgages of the company's undertaking issued by statutory companies.

⁷¹ (1864) 33 Beav 565; 55 ER 488.

sell anything without the chargee being entitled to receive the proceeds. To hold otherwise would paralyse the company and prevent it from carrying on its business. This reasoning echoes the words of Lord Truro LC and Sir HM Cairns from the statutory mortgage cases. It is based upon the concept that a charge in specie of debts owing to the company would allow the chargee at his whim to demand the company's book debts be paid directly to him. This would in turn make it impossible for the company to carry on its business.

*Re Marine Mansions Co*⁷² involved a building and development company which went into liquidation having previously issued debentures over its assets. The debentures contained a "pledge" of the property for the time being belonging to the company with all buildings, stock, receipts and revenues arising therefrom and a "first charge" on the undertaking, property, receipts and revenues as aforesaid. Page-Wood V-C construed the debenture to be a "specific charge and mortgage" of the land and buildings of the company, which would not in itself prevent the company carrying on its business, although he suggests the consent of the debenture holder would be needed to effectuate a sale of the property charged. The debenture also created a first charge on the other property mentioned, although there is no guidance in the judgment as to the meaning of "undertaking" in this context beyond the statement that the wording used did not include the capital of the company.

The decision is therefore inconclusive as to the meaning of "undertaking" but it does point out that, even though a large proportion of a company's property is subject to a specific charge, this will not paralyse the company. It may carry on in business. If it wishes to sell charged property it would get the debenture holder's consent. If it wished to use its "receipts and revenues" (which clearly includes its book debts) to acquire further property, it could get the charge transferred to the new property (probably feasible on the facts as the company's stock in trade was real property and the turnover would be unlikely to be rapid) or "deal with the debentures in some other way". This last point is not explained but it seems that, where the charge is over the company's income, if the company was unable to use the income without the express consent of the debenture holder each time it wished to use that income, then the company would indeed be paralysed. The only way to interpret the decision is that there must be some implied authority in the company to use the income in the ordinary course of business as in the bills of sale cases listed above.^{72A}

In *Re New Clydach Sheet and Bar Iron Co*⁷³ the company issued debentures secured by a mortgage of "the undertaking, and all the real and personal estate" of the company. Lord Romilly MR decided that the mortgage extended only as far as property which existed at the date of the mortgage and not to future or substituted goods. *Re Marine Mansions* was distinguished as the debenture there expressly referred to future property. There was no discussion of the meaning of "undertaking".

The courts addressed the meaning of "undertaking" in the context of registered companies fully for the first time in *Panama*,^{73A} where the Court of Appeal gave the term a wide interpretation which the courts subsequently developed into the floating charge. The form of the debenture in question was virtually identical to that of the old Schedule C

⁷² (1867) LR 4 Eq 601.

^{72A} *Supra*, n. 42.

⁷³ (1868) LR 6 Eq 514.

^{73A} (1870) 5 Ch App 318.

mortgage under the Companies Clauses Consolidation Act 1845 (the only difference of substance being that the word “mortgage” was replaced by the word “charge”). The decision appears to draw on elements from the previous three cases discussed and from the statutory company cases. The liquidator’s arguments founded upon the reasoning in the statutory mortgage cases but Giffard LJ refused to limit the meaning of “undertaking” to the income arising out of the company’s business.⁷⁴ On the facts of the case his Lordship decided that the debenture covered all the property of company both present and future. This part of the decision has its roots in the reasoning in *Re Marine Mansions* in that it recognises that the charge over the undertaking allows the company to continue to trade and to acquire future property.

Giffard LJ went on to explain that in the context of the case the term “undertaking” necessarily implies that the company will carry on trading. His Lordship points out expressly that the statutory mortgage cases have no application to *Panama*,^{73A} because in cases such as *Gardner*^{74A} the property charged was peculiar subject matter, *ie* a permanent railway, which could not be broken up whilst the company was a going concern for public policy reasons. The principal difference between *Panama* and the statutory company cases is that in *Panama* there are no public policy grounds to warrant protection of the company’s assets from the debenture holder. There is no overriding public utility in preventing the chargee from enforcing his charge even whilst the company is a going concern. Once there is a default by the company there is no reason why the debenture holder should not be able to enforce his charge. To borrow the imagery of Cairns LJ in *Gardner*, the debenture holder is entitled to chop down the “fruit bearing tree”.

The decision in *Panama* is, therefore, that the charge over the undertaking allows the chargee to have priority over ordinary trade creditors if the company is wound up and its assets are being realised (mirroring the position under the statutory mortgage cases⁷⁵) but also that the debenture holder is not prevented from enforcing his security whilst the company is a going concern as long as the company has defaulted under the terms of the debenture. Use of the term “undertaking” implies that the company will carry on in business; and the debenture holder cannot interfere so long as the company carries on its business in the ordinary way and complies with the debenture agreement.

It can be seen from this that the decision in *Panama* originated from the courts’ difficulties in interpreting the term “undertaking” out of its original context in the statutory form of mortgage. The courts at no time applied the bills of sale case law. Although *Holroyd v Marshall* is referred to in argument in *Panama* the court does not discuss it. It is relevant to *Panama*, only in that it is a decision of high authority which confirms the principle that equity recognises a charge over future and changing property. *Holroyd* is not a case on the meaning of undertaking nor is the security in question a floating charge.

The practice of companies charging their undertaking or all their property both present and future continued throughout the 1870s.⁷⁶ The next case of importance was the

⁷⁴ Giffard LJ had been counsel for the successful debenture holders in *Re Marine Mansions*, where he argued that the effect of a charge over the undertaking of a company was a charge on all the company’s real and personal property and that the company could only sell the charged assets with the consent of the debenture holders.

^{74A} (1867) 2 Ch App 201.

⁷⁵ *Re Glyn Valley Tramway Co* [1937] 1 Ch 465.

⁷⁶ See eg *Re General South American Co* (1876) 2 Ch D 337 and *Re Native Iron Ore Co* (1876) 2 Ch D 345.

Court of Appeal's decision in *Re Florence Land and Public Works Co, ex p Moor*.⁷⁷ It involved a debenture expressed to "bind" the company's "estate, property and effects". The court construed the debenture to be a charge over all the company's property both present and future subject to the company's power to carry on its business in the ordinary way, which included the power to dispose of charged assets. If the company were to default under the agreement, the debenture holder could ask the court for a receiver in order to realise his security or rely on his priority in a winding-up.

James LJ initially refers to the document as creating a "specific charge"^{77A} and later as a "special charge"^{77B} and decided that the words "estate, property, and effects" were exactly equivalent to "undertaking",^{77C} which we find in the other cases. This point is of importance as it widens the principle of *Panama* beyond the term "undertaking" and allowed for a type of charge where the company charged all its assets for the time being but by implication was allowed to continue to trade with them. Thesiger LJ also called the charge a "specific charge".^{77D} Neither judge considered that the specific charge in any way prevented the company from carrying on its business using the assets charged.

Jessel MR reached the same result but by a different route partly based on the company's articles. He decided that the document created "a security on the property of the company as a going concern, subject to the powers of the directors to dispose of the property of the company while carrying on its business in the ordinary course."^{77E} This in itself appears to be consistent with the majority but his Lordship went on to reject the view that the security could be a specific charge, reasoning that a specific charge on the property of the company would effectively paralyse the company as the company would be unable to use even the money borrowed because a third party with notice of the charge would be liable to repay it to the debenture holder. The company would be unable to lease or mortgage property without the consent of the debenture holder.⁷⁸ The charge as explained by Jessel MR is not a specific charge. The charge recognised by the majority of the court is a specific charge seemingly with a licence to deal with the assets charged. It is not possible to dismiss the majority's decision as merely mislabelling that which later became known as a floating charge. If they did not mean specific charge in the sense explained by Jessel MR they would surely not have used that phrase.

The following year in *Re Colonial Trusts Corporation, ex p Bradshaw*⁷⁹ Jessel MR sitting as a judge of first instance considered the effect of a debenture where the company's "real and personal estate" was charged. His Lordship followed his own judgment in *Re Florence Land* and referred to James LJ's judgment in that case as being entirely consistent with his own views. The case is famous for the judicial use for the first time of the phrase "floating charge"^{79A} to describe a charge on the company's assets for the time being where the company is left "to deal with them as they think fit till they are stopped

⁷⁷ (1878) 10 Ch D 530.

^{77A} *Ibid*, 544.

^{77B} *Ibid*, 546.

^{77C} *Ibid*, 546.

^{77D} *Ibid*, 550.

^{77E} *Ibid*, 540, 541.

⁷⁸ Jessel MR's explanation of the effect of a specific charge echoes his argument as counsel for the successful plaintiff in *King v Marshall* (1864) 33 Beav 565.

⁷⁹ (1879) 15 Ch D 465.

^{79A} *Ibid*, 472 ("floating mortgage or charge"). See also *ibid*, 468, 469, 472 ("floating security")

either by a receiver or a winding-up".^{79B} Jessel MR again points out his view that if the charge were not of this nature it would paralyse the company and prevent it from conducting its business.

In *Re Hamilton's Windsor Ironworks*⁸⁰ Malins V-C followed *Re Florence Land*. He construed a general mortgage of the company's property so as to permit the company to remain in possession of the mortgaged assets and use them for the purpose of carrying on its business in the usual way. This interpretation of the deed allowed the company to assign the fruits of a contract by way of charge to another creditor and for that creditor to gain priority over the general mortgagee. The case turned upon the construction of the general mortgage deed. In the course of explaining the effect of deed Malins V-C made these important observations:⁸¹

"But in what sense was it an assignment of all the property of the company? Did it mean that the company was thereby disabled from carrying on its business? Certainly not. It might be that the assignees under such a deed had a right, whenever they thought fit, to enter into possession of the property and stop the operations, but the meaning of the deed was that the Iron Company was to be left perfectly at liberty to carry on its business".

He points out that, although the deed in question was what shortly thereafter became known as a floating charge, a differently worded deed may have had a different effect. The judge recognises the possibility that a security interest could fix immediately on the secured assets and allow the company to use those assets whilst giving the mortgagee express power at any time to enter into possession. This is a description of a specific charge with a licence to deal. On the facts of the case this is not what the parties had intended but it is clearly a possibility. A specific charge with a licence to deal was not anything unusual at this time. In the next two years, for example, the courts continued their long settled approach to cases on bills of sale.⁸²

THE DRAFTSMAN'S REFUGE

The problems created by the Bills of Sale etc Act 1882 were life-threatening both to bills of sale in their traditional form as a specific security and to the new-fangled floating charge expressed to cover the "undertaking" and/or the "whole of the property present and future".

Release from the dilemma came with the Court of Appeal's decision in *Re Standard Manufacturing*⁸³ in February 1891. The charge here was expressed as one over the company's "undertaking and all its property both present and future". In three and a half pages of judgment delivered by Bowen LJ, following eleven pages of reported argument, *Brocklehurst*⁸⁴ and *Jenkinson*⁸⁵ were rejected and four judgments critical of those two

^{79B} *Ibid*, 469.

⁸⁰ (1879) 12 Ch D 707.

⁸¹ *Ibid*, 710.

⁸² See cases cited *supra*, 42.

⁸³ [1891] 1 Ch 627.

⁸⁴ [1884] WN 70.

⁸⁵ (1887) 19 QBD 568.

cases in the lower courts around 1890⁸⁶ were approved. Section 17 of the 1882 Act now applied to Companies Act companies.

After nine or ten years of serious uncertainty, commercial lenders and their draftsmen finally had a precedent which they could rely on and which would get them out ahead of unsecured creditors in the event of insolvency. Having thus found a security which worked, the draftsmen stuck to it like glue and the floating charge took off. Preferential claims did not trouble the banks' recovery until the Preferential Payments in Bankruptcy (Amendment) Act 1897 came into effect. When they did come into play, it seems that the amount of the claims was not too troublesome. The more traditional bill of sale type of drafting simply became commercially unfashionable.

Specific security with licence to deal

Although the bill of sale structure for commercial security instruments did not regain its former pre-eminence amongst banking Law draftsmen, the legal principles governing its nature, did not cease to exist. Buckley LJ in *Evans v Rival Granite Quarries*⁸⁷ pointed out that a floating charge "is not a specific mortgage of the assets, plus a licence to the mortgagor to dispose of them in the course of his business" and he expressly rejected a submission by the debenture holder "that it was competent to the mortgagee to intervene at any moment and to say that he withdrew the licence as regards any item".

In *Re Cimex Tissues*⁸⁸ Stanley Burnton QC upheld a fixed security upon scheduled machinery where the debenture gave a power to deal in the ordinary course of business. He did, however, hedge his bets a little by saying, first, that if the power to deal was "extensive"⁸⁹ he would have decided that the charge floated and, second, in applying *Holroyd v Marshall* to reach his conclusion, that it was "assumed"⁹⁰ in *Holroyd* that the charge was specific. In our submission neither of these two cautionary notes is justified. An "extensive" power to deal had been a commonplace of security financing arrangements for over 150 years before *Holroyd* and in 1862 specific security was the only form known to the law. In *Re Atlantic Computers*⁹¹ and *Re Atlantic Medical Ltd*⁹² charges over income from leases where the chargor did not control the bank account were held to be fixed and a similar result achieved by Jonathan Parker J in *Royal Trust Bank v National Westminster Bank*⁹³ was rejected by Nourse LJ on the ground that on the facts there was no licence granted.⁹⁴

The Companies Act 1985 itself recognises that security documents in the nature of bills of sale may still be executed by companies because in the list of charges registrable at Companies House is one which, if executed by an individual, would require registration

⁸⁶ *Read v Joannon* (1890) 25 QBD 300; *John Welsted & Co v Swansea Bank* (1889) 5 TLR 332; *Edmonds v Blaina Furnaces Co* (1887) 36 Ch D 215; *Levy v Abercorris Slate and Slab Co* (1887) 37 Ch D 260.

⁸⁷ [1910] 2 KB 979, 999.

⁸⁸ [1994] BCC 626.

⁸⁹ *Ibid*, 635, citing RM Goode, *Legal Problems of Credit and Security*, 2nd ed (1988), 56.

⁹⁰ *Ibid*, 636.

⁹¹ [1992] Ch 505.

⁹² [1993] BCLC 386.

⁹³ [1996] 2 BCLC 682.

⁹⁴ *Ibid*, 702h.

as a bill of sale (s 396 (1) (c)). Companies do have the advantage that charges registered under s 396 (1) (c) do not have to be in the form prescribed by the Bills of Sale etc Act of 1882 and are valid even if they would otherwise be struck down by the 1882 Act itself (*Dublin City Distillery v Doherty*⁹⁵ and *Welsh Development Agency v Export Finance Co Ltd*)⁹⁶. For most practical purposes the definition of debenture in *Levy v Abercorris Slate and Slab Co*⁹⁷ is sufficiently wide to prevent a charge over personal property from having to be in the statutory form of the Bills of Sale legislation.

There are important differences between the two types of charge—floating and specific with licence—in their operation.

- (i) Only a floating charge is liable to be avoided under the Insolvency Act 1986, s.245.
- (ii) The general priority position varies considerably.
- (iii) Priorities over judgment creditors are different. For example, if a charging order is made before a floating charge crystallises, the charging order prevails. This would not apply to a specific mortgagee.
- (iv) Whilst a floating charge continues to float, a set-off is effective,⁹⁸ whereas a mortgage of a debt destroys the possibility of mutuality.⁹⁹
- (v) Assets subject to a charge which as created was a floating charge are amenable to preferential claims in winding-up and receivership. Assets subject to a fixed charge are not so amenable.
- (vi) Realisation of a floating security requires, in Romer LJ's third characteristic, that some "step" be taken by the debenture holder.¹⁰⁰ In Fidelis Oditah's helpful phrase, that step means a step to bring "management autonomy"¹⁰¹ of the directors over the assets to an end. In a fixed charge security the charge holder can intervene at any time under the agreement without having to take steps to crystallise anything.

MODERN ISSUES

It will be obvious by now that in the authors' view the current debate over the fixed charge on book debts or other changing assets does not raise a real issue at all. As a matter of principle the objection to the insistence upon possession or control as a pre-requisite of certain specific equitable charges is that it inserts into modern equity a medieval common law rule which was developed to suppress a fraud which is no longer practised, a rule, moreover, which equity did everything in its power to evade. Specific security over changing assets with an express or implied power in the chargor to deal with them has a much

⁹⁵ [1914] AC 823.

⁹⁶ [1990] BCC 393, 410–411, *per* Browne-Wilkinson V-C.

⁹⁷ (1887) 37 Ch D 260.

⁹⁸ *Biggerstaff v Rowatt's Wharf* [1895] 2 Ch 93

⁹⁹ See Rory Derham, *Law of Set-Off*, 2nd ed (Clarendon Press, Oxford, 1996).

¹⁰⁰ *Re Yorkshire Woolcombers* [1903] 2 Ch 284, 295.

¹⁰¹ *Legal Aspects of Receivables Financing* (Sweet and Maxwell, London, 1991), 111. Thus, whilst the charge floats the chargee cannot single out any item of property and take it to realise his debt: *Evans v Rival Granite Quarries* [1910] 2 KB 979, 998 (Fletcher Moulton LJ), 999 (Buckley LJ). To similar effect is *Robson v Smith* [1895] 2 Ch 118, 126. In the absence of some restraint a mortgagee whose interest is specific can take any item of property (see *eg Greenbirt v Sme* (1876) 35 LT (NS) 168) subject, however, to an obligation not to choose and sell items so as deliberately to destroy the value of the whole of what he sells a part (*Champagne Perrier-Jouet SA v HH Finch Ltd* [1982] 1 WLR 1359).

more venerable pedigree than the floating charge. The difficulty with the cases since *Siebe Gorman*¹⁰² is that they proceed on the false assumption that, because the power to deal exists as a component of the floating charge, such a power cannot exist in relation to certain fixed charges. Debating from false premises is likely to lead to confusion.

A few examples are noted here.

(a) It is an “extreme commercial improbability” that a chargor who does not operate the bank account would wish to control it; therefore, a charge must float notwithstanding that the charge is stated to be fixed (*Re Brightlife Ltd*).¹⁰³ *William Gaskell Group v Highley*¹⁰⁴ takes the opposite view. In *Whitton v ACN*¹⁰⁵ Bryson J specifically dissented from the approach of *Re Brightlife* as being irreconcilable with the third of Romer LJ’s characteristics in *Re Yorkshire Woolcombers Ltd*. The Irish Supreme Court in *Re Wogan’s (Drogheda) Ltd*^{105A} has recently sided with the opposition to *Re Brightlife*.

(b) In *Re Portbase Clothing Ltd*¹⁰⁶ counsel conceded on behalf of a private debenture holder that, without control of the bank account, the charge must float even though stated to be fixed. In contrast in *Royal Trust Bank v National Westminster Bank Plc*¹⁰⁷ counsel for the bank account operator (Natwest) conceded that his opponent’s charge over debts was fixed despite the absence of control.

(c) In *Re G.E. Tunbridge Ltd*¹⁰⁸ the court held a charge to float where (i) it was stated to be fixed and (ii) in cl 6 of the debenture there was an express prohibition on selling the relevant assets “without the prior written consent of the lender”. In *Re Cimex Tissues Ltd*¹⁰⁹ the court held that a charge was fixed where there was a schedule of machinery attached to the debenture and an express power to dispose of the assets charged. The judge followed Professor Goode’s view that, if the power to deal was not “extensive”, then that might not be inconsistent with fixed charge. We note here that *Holroyd v Marshall* was cited in support of the judge’s conclusion.

(d) In *Royal Trust Bank*^{109A} by RTB’s debenture “Brookes” (the borrower) “hereby assigns” all the interests benefit *etc* in the leases and RTB agrees to “reassign” them back to Brookes on redemption. Brookes was to collect the income from the leases as “agent” for RTB (cl 31(i)) of the debenture). By cl 15 RTB had an option to invoke stronger powers to control the collection and payment in of funds. Notwithstanding counsel’s concession that the charge was fixed, Millet LJ stated that the charge floated.

(e) The *Royal Trust Bank* case does raise some questions. The problem is that c. 3(1)(i), even with cl 15, cannot create merely a charge. The words are “assigns” and “will . . . reassign . . . the agreements and other rights assigned hereunder”. The references to assignment and reassignment are not mere labels. They are words of substance. In consequence they transfer nothing less than an equitable *title* over the relevant rights to RTB. A charge,

¹⁰² [1979] 2 Lloyd’s Rep 142.

¹⁰³ [1987] Ch 200.

¹⁰⁴ [1993] BCC 201.

¹⁰⁵ (1996) 14 ACLC 1799, 1810–1814.

^{105A} [1993] 1 IR 157

¹⁰⁶ [1993] BCC 96.

¹⁰⁷ [1996] 2 BCLC 682.

¹⁰⁸ [1994] BCC 563.

¹⁰⁹ [1994] BCC 626.

^{109A} [1996] 2 BCLC 682.

whether fixed or floating, on the other hand, confers no title and no possession, as Lord Hoffmann expressly points out in *Re BCCI (No 8)*.¹¹⁰

(f) Millett LJ's analysis also suffers from the weakness that in a mere charge case there is no retransfer of any proprietary interest from chargee to chargor on redemption (see *per* Lord Atkinson in *De Beers Consolidated Mines Ltd v British South Africa Co*).¹¹¹ That of course is precisely the opposite of the agreement which appears in Royal Trust Bank's debenture.

(g) Furthermore, Millett LJ's approach to the meaning of the debenture falls foul of the well-known rule of construction of contracts laid down by the House of Lords in *Whitworth Street Estates Ltd v Miller*¹¹² that what the parties do about a contract after it has been made must not be allowed to affect its meaning.

(h) In *Re Cosslett (Contractors) Ltd*¹¹³ the Court of Appeal held that the power of sale in the ICE standard form of contract created a floating charge on plant, materials and equipment on the employer's site notwithstanding that the employer could refuse to let items go back to the contractor and could sell them to recoup loss caused by failure of the contractor to complete the contract. If this case had been decided in the 1790s instead of the 1990s, the facts here would constitute a *novus actus* sufficient to satisfy the sort of eighteenth century common lawyer who disdained a pillow in favour of Bacon's *Maxims*.

SUMMARY

Since this has been something of a sprawling exposition of long strands of law, a simplified chronology may help.

1. 1709: specific security over changing assets accepted in equity (not law).
2. Bills of sale over all of a trader's present and future assets become common throughout the eighteenth century. Debts were included by 1758 at the latest. The borrower deals with the assets.
3. 1804: Lord Eldon expressly implies the power to deal in order to give business efficacy to bills of sale. This was merely taken for granted before, though it is the basis of the "order and disposition" cases in bankruptcy.
4. 1862: *Holroyd v Marshall* ends the common law and equity dispute about the effect of future property mortgages.
5. 1870: *Panama* lays down some new ideas about the old Companies Clauses Act statutory form of mortgage borrowed for a Companies Act company (the floating charge).
6. 1882: the Bills of Sale etc Act outlaws future property bills of sale.
7. 1884–1887: decisions on the 1882 Act render nugatory the operation of the s 17 exception for company debentures.
8. 1891: *Standard Manufacturing*, a floating charge case, gives full scope to s 17. The floating charge takes off.
9. 1979: *Siebe Gorman* raises the "modern" issue of fixed charges on book debts. Control of the bank account test is laid down.

¹¹⁰ [1997] 3 WLR 909, 197H.

¹¹¹ [1912] AC 52, 69.

¹¹² [1970] AC 583.

¹¹³ [1998] 2 WLR 131; [1997] BCC 724.

Counsel for Arco pointed out that Allocation Agreements were frequently not signed until the last moment and that in this instance they had been only been a few days late in a contract that was intended to run for 14 years. In these circumstances could it really have been the intention of the parties that the whole contract should go for such a small matter, especially bearing in mind the huge consequences? Lord Steyn and Lord Hope of Craighead, in particular, would like to have reached a decision in Arco's favour. But even they could not do so.

The majority of the House thought that *Aberfoyle Plantations Limited v. Khew Bain Cheng* [1960] A.C. 115 was relevant but Lord Steyn thought it unhelpful because it concerned a land transaction. This apart, no differences in law emerged in the House. What is important about the decision is that first Peter Gibson and Otton L.JJ. and then the House of Lords did not follow some supposedly liberal rule of construction (perhaps even invent one) to find in favour of the merits of the case. Would the decision of today have been reached by a court a few years ago? This must be a matter of real doubt. Perhaps the Chancery judges (with the honourable exception of Peter Gibson L.J.) thought overmuch about the consequences of their judgments, whereas the others thought more about what the parties had said in their professionally drafted agreement. The approach of Peter Gibson L.J. was surely the right one. Those who care about the proper construction of agreements, and statutes, must care that words are given their correct meaning and not some artificial meaning to suit a particular result. Everyone must be grateful to the House of Lords for their decision in this case.

B. J. DAVENPORT.

BOOK DEBT CHARGES—THE SAGA GOES ON

In *Re Westmaze Ltd* (May 15, 1998) the company ("Westmaze") borrowed £53,000 from Excelsior and by a debenture gave a "first fixed" charge over "all book and other debts revenues and claims both present and future....". These were the "Charged Assets". The debenture also provided that Westmaze should "not (without the previous consent in writing of Excelsior) transfer lease or dispose of the Charged Assets". The Inland Revenue succeeded in its contention that the debt charge floated and Excelsior ranked behind preferential claims.

Mr David Oliver Q.C., sitting as a Deputy High Court Judge, held that Westmaze's power to deal with the proceeds was the badge of a floating charge and refused to construe the negative pledge "as precluding the operation of a bank account in the ordinary course of that business". He also declined to enter into the *Re New Bullas Trading Ltd* [1994] B.C.C. 36 distinction between a debt and its proceeds (though doubting whether they were always inseparable) on the ground that the charge here referred to

“revenues” which “clearly” included “proceeds upon realisation”. He was reinforced in his view by *Re Brightlife Ltd* [1987] Ch. 200 and *Re Pearl Maintenance Services Ltd* [1995] B.C.C. 657.

In *Re Double S Printers Ltd* (March 25, 1998), the chargee (as with *Westmaze*) was not the cheque clearing bank. The facts are, however, the converse of those in *Westmaze*—there was no contractual restraint on disposal or dealings but the chargee was a director, cheque signatory and actual controller of the company’s bank account. Jonathan Parker J. sitting in Leeds, held that control of the bank account was relevant only if exercised by him as chargee, not as director, because in the latter capacity he could only act bona fide in the company’s interests, rather than for collateral purposes. A further weakness in the chargee’s case was that control and directorship were conterminous. The charge, therefore, floated and preferential claims ranked first.

The apparent surefootedness of these two judgments only serves to emphasise the predicament of would-be fixed chargees. The vulnerability of floating charges until crystallisation to subsequent dealings, charges, set-offs and enforcements combined with deferment on crystallisation to preferential creditors and, pace *Re Portbase (Clothing) Ltd* [1993] B.C.C. 96, the expenses of liquidation, render such security somewhat insecure.

The great question is: Where, and how, is the line to be drawn between fixed and floating charges? There are no clear answers, even in relation to the most fundamental issues such as what a fixed charge actually is. For example, the Comptroller and Auditor General thinks it is a mortgage (see Report to the DTI, HC695 Session 1995–1996, October 17, 1996 “Glossary of Terms”); Lord Hoffmann in *Re BCCI (No. 8)* [1998] A.C. 214 at p. 226, with whom we respectfully agree, points out that a charge confers neither title nor possession; according to Farwell J. “The very essence of a specific charge is that the assignee takes possession . . .” (*Re Yorkshire Woolcombers Association Ltd* [1903] 2 Ch. 284 at p. 289); *Holroyd v. Marshall* (1862) 10 H.L.C. 191 actually decided that an equitable mortgage of future personalty is complete without possession; in *Re Keenan Bros Ltd* (1986) 2 B.C.C. 98,970 at p. 98,973 Henchy J. said that the “distinguishing features of a fixed charge” would entail “assets . . . withdrawn from ordinary trade use, put in the keeping of the debenture holder and sterilised and made undisposable save at the absolute discretion of the debenture holder”. Millett L.J. wanted to see “control” vested in the debenture holder (*Re Cosslett (Contractors) Ltd* [1997] B.C.C. 724); and in *Re Atlantic Computer Systems Plc* [1992] Ch. 505 and *Re Atlantic Medical Ltd* [1993] B.C.C. 386 the absence of control over the proceeds did not cause a charge covering lease income to float.

Furthermore, in plotting this line “a floating charge is consistent with some restriction upon the company’s freedom to deal with its assets” and a power to deal which is not “extensive” is consistent with a fixed charge

(respectively *Brightlife*, *supra*, at p. 209 and *Re Cimex Tissues Ltd* [1994] B.C.C. 626 at p. 635).

As regards debentures in favour of clearers of the chargor's bank account, a direction to pay proceeds into the account plus minimal restrictions suffice to create a fixed interest. Non-clearing chargees stand on less certain ground. Non-contractual *de facto* control is insufficient (*Double S Printers*, *supra*), as is an unexercised contractual power to open and control a bank account (*per* Knox J. in *Re New Bullas Trading Ltd* [1993] B.C.C. 251 at p. 260). In addition, clauses restraining all dealings without prior chargee consent have been variously treated—they do not prevent the operation of the account in the ordinary course of business (*Wetsmaze*); they are in line with the kind of restriction to be expected in a floating charge (*Re G.E. Tunbridge Ltd* [1994] B.C.C. 563 at p. 567); and they are an “extreme commercial improbability” which cannot have been intended (*Brightlife*, *supra*, at p. 209). In a further contrast to *Brightlife*, the relevance to the construction of the charge document of (a) post contractual conduct and (b) extraneous agreements, such as bank mandates, has been doubted (see respectively Bryson J. in *Whitton v. ACN* (1996) 14 A.C.L.C. 1,799 at p. 1,813 and Knox J. *Re a Company No. 005009 of 1987* (1988) 4 B.C.C. 424 at pp. 434–435).

There is a question as to the true nature of the security interest acquired by the lender in *Royal Trust Bank v. National Westminster Bank Plc* [1996] B.C.L.C. 682. There RTB took an assignment of the debts of Brookes (the borrower) and agreed to reassign them on redemption. Brookes was “agent” to collect debts and pay into an account at Natwest. RTB took further powers to open its own bank account with Brookes and require Brookes to credit proceeds or, on demand, terminate Brookes's power of collection and collect them itself. Natwest conceded that RTB's charge was fixed. Nourse L.J. held that the chargor/chargee relationship was insufficient to create a trust and that Brookes was merely under a duty to account to RTB (*supra*, at p. 701). Millett L.J. held there was a floating charge (at p. 706). The issue was fogged by the concession. In the author's submission assignment and agreement to reassign on redemption are words of mortgage, not charge. Furthermore in a charge there is no retransfer on redemption (*De Beers Consolidated Mines Ltd v. British South Africa Co.* [1992] A.C. 52 at p. 69).

The third of the recent cases, *Coakley v. Argent*, June 12, 1998, invites a question on equitable interests in personalty. The chargee had a debenture, which Rimer J. held to float over book debts, and a later assignment (absolute in form) over certain claims to insurance proceeds. Applying the “improbable commercial miracle” test Rimer J. decided that the assignment was by way of charge and, since the right to the proceeds was not a “book” debt, it was valid without registration. The case resembles *Pearl Maintenance*, where the factor had a debenture floating on

debts and a separate assignment (absolute, unlike that in *Coakley*) of debts. In neither of these cases was merger of interests discussed, though it might have affected the nature of the argument in *Coakley* and the outcome of *Pearl Maintenance*.

As Knox J. pointed out in *Re a Company No. 005009* (1988) 4 B.C.C. 424 at p. 435 this "class of work" is one in which the value of precedents and certainty is very important. The controversies which presently surround security over personalty are damaging to lenders and borrowers.

ROGER GREGORY.*

PETER WALTON.*

MURDER, *MENS REA*, AND THE HOUSE OF LORDS—AGAIN

ON August 16, 1994, Stephen Woollin lost his temper. He threw his three-month-old son against a hard surface. The child's skull fractured and death ensued. Woollin was convicted of murder. At issue, both during trial and on appeal, was *mens rea*: whether he had intended to inflict serious injury upon the child. It was not contended by the Crown that he had intended to kill, nor that he had desired to cause death or serious injury. Rather, the prosecution's case was that Woollin must have realised that his actions were virtually certain to cause serious injury to the baby; therefore, in law, he intended to cause such injury.

Summing up, the Recorder of Leeds had directed the jury largely in accordance with the guidelines set out by the Court of Appeal in *Nedrick* [1986] 1 W.L.R. 1025 at p. 1028, in which Lord Lane C.J. had said that where specific guidance on intention was required, "the jury should be directed that they are not entitled to infer the necessary intention, unless they feel sure that death or serious bodily harm was a virtual certainty (barring some unforeseen intervention) as a result of the defendant's actions and that the defendant appreciated that such was the case." Unfortunately, the summing up also contained the following passage: "[If you] are quite satisfied that he was aware of what he was doing and must have realised and appreciated when he threw that child that there was a substantial risk that he would cause serious injury to it, then it would be open to you to find that he intended to cause injury to the child and you should convict him of murder." Before both the Court of Appeal ([1997] 1 Cr.App.R. 97) and the House of Lords ([1998] 3 W.L.R. 382), the appellant claimed this passage constituted a misdirection, because it defined intention by reference to foresight of a substantial risk rather than (*per Nedrick*) of a virtual certainty. There is no question but that these are materially different definitions. What was at issue, therefore, was whether

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Book Debt Charges: Following Yorkshire Woolcombers—Are We Sheep Gone Astray?

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Introduction

The authors are not looking forward to the arrival of the New Zealand Court of Appeal's decision in *Re Brumark Investments Ltd*¹ for hearing in the Privy Council because their Lordships will probably have to come clean and finally tell us what a floating charge really is. In so doing they will probably blow the final whistle on one of the most fascinating spectator sports in legal history which has engaged hundreds of players and commentators and has provoked stunning intellectual feats.

In all the vagaries and contradictions which abound,² especially in the fixed/floating dichotomy of book debt charges, two things have appeared reliable: one is Professor Goode's statement that the "precise nature of the floating charge remains a matter of controversy"³; the other is that when the courts have to plaster over the cracks in the floating charge structure they need only apply a bit of *Yorkshire Woolcombers*.⁴ In the authors' view that leaves only Professor Goode standing.

The *Yorkshire Woolcombers*' judgments are largely characterised by the famous exchange between Vaughan Williams L.J. in the Court of Appeal and Lord Macnaghten in the House of Lords. Vaughan Williams L.J.⁵ commented that Lord Macnaghten's purported definition of a floating charge in *Governments Stock and Other Securities Investment Co. Ltd v. Manila Railway Co. Ltd*⁶ used the word "dormant",⁷ which could not amount to definition because the word was applicable not directly but only by analogy. In response Lord Macnaghten readily disclaimed definitional significance for "dormant" but equally readily claimed it for "ambulatory and shifting . . . hovering over and so to speak floating . . ."⁸ On the day the difference between specific and floating security proved no less elusive than the difference between analogy and definition.

The security document in *Yorkshire Woolcombers* had the following characteristics:

- (a) It was drafted as a mortgage not a charge.
- (b) It related simply to book debts.
- (c) The security holders were trustees who had the benefit of the following clause:

"[they shall not] . . . be answerable for, or in anywise chargeable on account of, permitting or authorizing the association to receive all or any such debts, or to deal with the same or the proceeds as if they were not subject to the mortgage hereby created."⁹

The mortgage was not registered in the Companies Registry. The question was whether it was a floating charge which required registration. At that time a security over book debts was not a distinct category of registrable security interest.¹⁰

¹ [1999] N.Z.C.A. 227.

² See e.g. Gregory and Walton, "Book Debt Charges—the Saga Goes On" (1999) 115 L.Q.R. 14.

³ "The Exodus of the Floating Charge" in Feldman and Meisel (eds.), *Corporate and Commercial Law: Modern Developments* (Lloyds of London Press, 1996), p.193 at p.197.

⁴ *Re Yorkshire Woolcombers' Association Ltd* [1903] 2 Ch. 284, High Court and Court of Appeal decisions reported together. The House of Lords adopted both courts' decisions *sub nom. Illingworth v. Houldsworth* [1904] A.C. 355.

⁵ [1903] 2 Ch. 284 at 291–282.

⁶ [1897] A.C. 81.

⁷ *ibid.* at 86. This repeats Lord Macnaghten's characterisation of a floating charge in *Tailby v. Official Receiver* (1888) 13 App.Cas. 523 at 541.

⁸ [1904] A.C. 355 at 358.

⁹ [1903] 2 Ch. 284 at 287.

¹⁰ Companies Act 1900, s.14 listed securities requiring registration. Companies Act 1907, s.10 added mortgages and charges over book debts to this list shortly after the decision in *Yorkshire Woolcombers* on the recommendation of the Warmington Committee (Report of the Company Law Amendment Committee 1906 (Cd. 3052), para. 37).

The decision in all three courts was that the transaction amounted to a registrable floating charge. The judgments are notable for their conciseness and the absence of analysis and authority in support of some resounding *ex cathedra* propositions which appear in them. Some of these merit consideration rather than the unhesitating acceptance and citation which has followed. It is proposed to consider a few of them in this article.

Yorkshire Woolcombers

*"The very essence of a specific charge is that the assignee takes possession, and is the person entitled to receive the book debts at once."*¹¹

This view was approved by Hutton J. in *Re Armagh Shoes Ltd*¹² in settling the test of control of the bank account in which proceeds of the chargor's debts are held.¹³ Henchy J.'s "keeping", "sterilised and made undisposible" in *Re Keenan Bros Ltd*¹⁴ is to the same effect. Other book debt charge cases follow this pattern.¹⁵ The consequence is that the only way to have a fixed charge on book debts is to give notice to the debtors or to take possession of the proceeds of book debts. It is interesting that Farwell J. did not cite any case law in support of his sentence. The reason for this is that there is none. In 1903 that sentence was erroneous, *per incuriam* and destructive of the root principle of the equitable charge.

Cases decided prior to *Yorkshire Woolcombers* suggest overwhelmingly that a mortgage of assets which did not require possession to pass to the mortgagee and permitted the mortgagor to carry on business using the mortgaged assets in the ordinary way were standard commercial practice.¹⁶ They were effective in equity and fixed on to future assets as soon as those assets came into existence.¹⁷ In order to promote trade, equity always permitted either an express or implied power in the mortgagor to deal with the mortgaged assets. Mortgages over debts were treated in the same way as stock in trade, machinery and equipment.

The decisions turned upon a number of issues. The common law refused to recognise a mortgage of future personalty without a *novus actus*, usually mortgagee possession. Equity's view for centuries was that such possession was not required. Chancery also had to contend with disputes between moneylenders with mortgage securities and other creditors of the mortgagor. The outcome usually depended upon a variety of statutory provisions introduced piecemeal to alter the balance between the interests of secured and unsecured creditors. The most common disputes included the effect of the order and disposition clause in

¹¹ [1903] 2 Ch. 284 at 289 *per* Farwell J.

¹² (1984) 1 B.C.L.C. 405 at 415.

¹³ In the context of bank accounts, the requirement of possession seems to be satisfied by the bank exercising control over the bank account: see Viscount Simonds in *Rahimtoola v. Nizam of Hyderabad* [1958] A.C. 379 at 395.

¹⁴ (1986) 2 B.C.C. 98, 970 at 98, 976.

¹⁵ See *e.g.* *Chalk v. Kahn* (February 29, 2000, unreported); *Re ASRS Establishment Ltd*, *The Times*, November 17, 1999; *Re Brumark Ltd* [1999] N.Z.C.A. 227; *Re Westmaze Ltd* [1999] B.C.C. 441; *Re Double S Printers Ltd* [1999] B.C.C. 303; *Royal Trust Bank v. National Westminster Bank plc* [1996] B.C.C. 613; *Re New Bullas Trading Ltd* [1994] B.C.C. 36; *Re Brightlife Ltd* [1987] Ch. 200; *Siebe Gorman & Co. Ltd v. Barclays Bank Ltd* [1979] Lloyd's Rep. 142.

¹⁶ See the list of cases in the Appendix to this article.

¹⁷ *Ryall v. Rolle* (1749) 1 Atk. 165 *per* Lord Hardwicke. In line with the bankruptcy practice at the time, however, Lord Hardwicke called in other judges, who came from the common law courts and firmly placed mortgages where the mortgagor remained in possession with power to deal within the order and disposition clause of the Bankruptcy Act 1623. The other landmark cases are *Bucknal v. Roiston* (1709) Prec. in Ch. 286; *Nutbrown v. Thornton* (1804) 10 Ves. Jun. 160; *Re Ship Warre* (1817) 8 Price 271. Cf. the common law proceedings in the same case reported as *Robinson v. McDonnell* (1816) 5 M. & S. 228; *Davenport v. Whitmore* (1836) 2 My. & Cr. 521; *Holroyd v. Marshall* (1862) 10 H.L.C. 191.

bankruptcy,¹⁸ fraudulent conveyances as acts of bankruptcy,¹⁹ the Statute of Frauds,²⁰ the Bills of Sale Acts²¹ and competition between mortgagees on the one

¹⁸ In *e.g. Re Eslick* (1876) 4 Ch.D. 496 a mortgage by an upholsterer of *inter alia* stock in trade and future goods was followed by the mortgagor filing for liquidation under the Bankruptcy Act 1869. He had remained in possession and carried on business for nearly four months following the mortgage. Due to attempts to enforce the mortgage prior to the liquidation, the court held that the goods were not at the time of filing any longer in the order and disposition of the mortgagor with the consent of the true owner. The mortgage was upheld.

¹⁹ In *e.g. Ex p. King* (1876) 2 Ch.D. 256 a brewer mortgaged *inter alia* the effects placed on the property during the continuance of the security. Substantially all the mortgagor's property was mortgaged but because the mortgage was in consideration of a fresh advance of money it was held not to be an act of bankruptcy. James L.J. commented at 263: "I come to the conclusion that the advances were substantial, and were bona fide made for the purpose of enabling the debtor to carry on his trade".

²⁰ 13 Eliz. 1 c. 5—codifying the common law rule. See *Bucknal v. Roiston* (1709) Prec. in Ch. 285 and *Edwards v. Harben* (1788) 2 T.R. 587.

²¹ In order to combat the potential fraud of secret mortgages of chattels the Bills of Sale Act 1854 required public registration. Non-registration had the consequence, *inter alia*, that the mortgage was void against a judgment creditor—see *e.g. Hawtry v. Butlin* (1873) 8 Q.B. 290.

hand and subsequent purchasers²² or judgment creditors²³ on the other.

Prior to, and briefly for a period after, the invention of the floating charge,²⁴ it was extremely common for trade lending to be financed by mortgages of present and future personalty which attached to assets as they circulated, which permitted dealing with the mortgaged assets and substitution of newly acquired assets for those dealt with. As James L.J., one of the originators of the floating charge, stated in *Ex p. Games*²⁵:

"The mortgagor was intended to remain in possession of the property and to carry on his business, substituting new chattels for those which he sold in the course of his business, and the security of the mortgagee was to remain upon the substituted chattels. He got the substituted chattels in place of those which he allowed to be withdrawn by the mortgagor."

Farwell J.'s requirement for possession is *per incuriam*. *Holroyd v. Marshall*²⁶ is clear House of Lords authority that possession is not a prerequisite of an equitable interest or title. It decided that in equity a mortgage of present and future "machinery implements and things" fixed in or placed about a mill, was complete as regards future items as soon as property covered by the terms of the mortgage came into the mortgagor's hands. *Tailby v. Official Receiver*²⁷ (Lord Macnaghten excepted) was to the same effect as *Holroyd*.²⁸

As a matter of principle there are deeper objections to Farwell J.'s *dictum*.

- (1) It subsumes a fixed equitable charge into a common law pledge—the very thing equity fought against for several hundred years.
- (2) If Farwell J. is right, then the process of crystallisation of a floating charge through, for example, winding up, cessation of business or non-compliance with a demand, does not operate to convert the floating charge into a fixed charge since none of those events involves possession.
- (3) Farwell J.'s *dictum* entails the consequence that there is no such person as a specific chargee but only a specific chargee in possession. The severe consequences visited upon mortgagees in possession normally dictate that mortgagees do not take possession.²⁹ The notion that one cannot also acquire the status of a fixed chargee without the penalties of possession is difficult to comprehend.³⁰
- (4) Possession (or a right to it) would confer a special property in the personalty subject to the charge and would, therefore, be protected by common law action. Such an action, however, is not available in support of an equitable interest *simpliciter*. If it were, *MCC Proceeds Inc. v. Lehmann Bros International (Europe)*³¹ would be wrongly decided. Interestingly, the Court of Appeal in that case relied on the future personalty mortgage cases of *Joseph v. Lyons*³² and *Hallas v. Robinson*³³ to show that such mortgages, being purely equitable, did not carry common law remedies and that the Judicature Acts had not confounded legal and equitable interests.

"A specific security is that which is given on specific property."³⁴

Farwell J.'s insistence that a specific security was one given on specific property is entirely consistent with the future property mortgage cases, in which identification by class description was standard practice. The common law recognised class description but, unlike equity, regarded a mortgage transfer of future property, in the absence of a *novus actus*, as nothing more than a contract. This battle between the common law and equity was finally won by equity in the House of Lords case of *Holroyd v. Marshall*.³⁵ Following the Judicature Acts 1873–75, the equitable rule had to be applied in all Divisions of the High Court.³⁶

The only dispute remaining was as to the meaning of specific property. In *Holroyd*, certain dicta of Lord Westbury suggested that an equitable mortgage of future property would only be valid if, on the facts, specific performance would be granted. The Court of Appeal used these dicta to introduce a new concept of vagueness, that is, if specific performance would not be available regarding the future property in question, the property was too uncertain and consequently there could be no equitable mortgage.³⁷ This fledgling doctrine was dismissed, again by the House of Lords, in *Tailby v. Official Receiver*,³⁸ where it was held that

²² The mortgagee could challenge a sale by the mortgagor if not effected in the ordinary course of business—see e.g. *Payne v. Fern* (1881) 6 Q.B.D. 620 and *Walker v. Clay* (1880) 49 L.J.Q.B. 560.

²³ See e.g. *Bradley v. Copley* (1845) 1 C.B. 685 where a mortgage was executed over present and future property. The mortgagor was permitted under its terms to possess and make use of the assets until default. Prior to default the sheriff seized goods under a writ of *fifa*. An action by the mortgagee in trover failed because until default he had no right to possession.

²⁴ Taken to be *Re Panama, New Zealand and Australian Royal Mail Co* (1870) 5 Ch.App. 318.

²⁵ (1879) 12 Ch.D. 314 at 323.

²⁶ (1862) 10 H.L.C. 191.

²⁷ (1888) 13 App.Cas. 523.

²⁸ As Halsbury says, "the grantor of a security bill of sale will almost invariably remain in possession himself". (Vol. 4 (1) Bills of Sale, para. 798).

²⁹ See e.g. *White v. City of London Brewery* (1889) 42 Ch.D. 437 for a consideration of the onerous duties of a mortgagee in possession. See also *Medforth v. Blake* [1999] B.C.C. 771 at 766 *per* Scott V.-C.

³⁰ See e.g. *Fisher and Lightwood on Mortgages* (10th ed., Butterworths, London, 1988), p. 4: "A charge is the appropriation of real or personal property for the discharge of a debt of other obligation, without giving the creditor either a general or special property in, or possession of, the subject of the security".

³¹ [1998] 4 All E.R. 675.

³² (1884) 15 Q.B.D. 280.

³³ (1884) 15 Q.B.D. 288.

³⁴ [1903] 2 Ch. 284 at 289 *per* Farwell J.

³⁵ (1862) 10 H.L.C. 191.

³⁶ *Anon* [1875] W.N. 203.

³⁷ *Belding v. Read* (1865) 3 H. & C. 955.

³⁸ (1888) 13 App.Cas. 523.

a mortgage of book debts from any business that might be carried on by the mortgagor was specific and, applying *Holroyd*, became effective as soon as future debts arose, without the need for any *novus actus* or any requirement to show that specific performance would be available. Width of language must not be confused with vagueness.

*"A charge on all book debts which may now be, or at any time hereafter become charged or assigned, leaving the mortgagor or assignor free to deal with them as he pleases until the mortgagee or assignee intervenes, is not a specific charge, and cannot be."*³⁹

One cause of the present contradictory positions taken up in relation to charges over book debts (as well as other personalty) is use of language. As Fisher and Lightwood say, "Both 'mortgage' and 'charge' are often loosely used as a generic term for all species of security. . . . The mortgage and charge have, indeed, been gradually assimilated, so that today for practical purposes there is little difference between them . . . though the fundamental difference in their nature remains".⁴⁰ Judicial examples of this interchangeability approach to "mortgage" and "charge" are *Yorkshire Woolcombers*⁴¹ itself, *Royal Trust Bank v. National Westminster Bank plc*⁴² and *Re Margart Pty Ltd.*⁴³ Extrajudicially the Comptroller and Auditor General⁴⁴ defined a mortgage as a fixed charge.

Whatever the position may be in relation to land, corporate mortgages and charges over personalty are still the almost exclusive domain of common law and equity and there are practical consequences turning on the distinction.

Legal Mortgage: This involves a transfer of the legal title. It also confers a right to possession (which can be contracted out of, waived or licensed away).

Equitable Mortgage: This involves a transfer of an equitable title. Obtaining possession is somewhat more indirect than it is at law because the mortgage is complete without possession. It can be obtained by, for example, an express contractual provision, the exercise of any right to call for the legal title or a court order. In the case of *choses in action* the process of serving notice on the principal debtor to avoid problems such as the rule in *Dearle v. Hall*⁴⁵ and the bona fide legal purchaser for value without notice, also constituted, under the Bankruptcy Acts, "possession" for the (purely statutory) purposes of the order and disposition clause.⁴⁶

Equitable Charge: This confers neither title nor possession.⁴⁷

There are differences in relation to remedy, for example, remedies in tort are not available to protect purely equitable interests, a mere chargee cannot foreclose⁴⁸ and the power of sale is implied in mortgages of personal property. The process of redemption is entirely different.⁴⁹ As a consequence the judgments of Lord Hoffmann in *Morris v. Agrichemicals Ltd*⁵⁰ and Millett L.J. (as he then was) in *Re Cosslett Contractors Ltd*,⁵¹ which expressly distinguish mortgages from charges, are very helpful.

An example of the confusion of principle which may arise if the distinction between "mortgages" and "charges" is not maintained is *Royal Trust Bank v. National Westminster Bank plc*.⁵² There the words creating the security were that Brookes, the borrower, "assigns" the debts to Royal Trust and the latter agreed to reassign them to Brookes on redemption. In addition Brookes was appointed as agent of Royal Trust to collect the income from the leasing and hire purchase agreements, which constituted the subject matter of the security. The Court of Appeal's judgments, apart from one reference,⁵³ treat the transaction as one of charge (National Westminster conceded that Royal Trust had a fixed charge). This raises the following issues:

- (1) In the case of a charge there is nothing to retransfer upon redemption because no title is transferred to a chargee by virtue of a charge.⁵⁴ The clause in *Royal Trust Bank* is to the opposite effect. It created a mortgage, which is incapable of being a floating charge.
- (2) The implied term which Millett L.J. used to find a floating charge⁵⁵ is inconsistent with Royal Trust's title and a term cannot be implied if it contradicts an express term.⁵⁶
- (3) The Court⁵⁷ applied *Henry v. Hammond*.⁵⁸ The issue at stake there was whether the agency relationship (the only relationship between the parties) was of a proprietary character. It is perfectly clear that an agency may or may not have that character. It is equally clear that a mortgagor/mortgagee

³⁹ [1903] 2 Ch. 284 at 289 per Farwell J.

⁴⁰ Fisher and Lightwood on Mortgages (10th ed., Butterworths, London, 1988), p. 5.

⁴¹ *Re Yorkshire Woolcombers' Association Ltd* [1903] 2 Ch. 284 and *Illingworth v. Houldsworth* [1904] A.C. 355.

⁴² [1996] B.C.C. 613.

⁴³ [1985] B.C.L.C. 314.

⁴⁴ Report to the DTI HC695 Session 1995-96, October 17, 1996 "Glossary of Terms".

⁴⁵ (1823-28) 3 Russ. 1.

⁴⁶ An early discussion is *Jones v. Gibbon* (1800) 1 Ves. 461 per Lord Eldon.

⁴⁷ See e.g. Peter Gibson J. in *Carreras Rothmans v. Freeman Mathews Treasure* [1985] Ch. 207 at 227 and Lindley L.J. in *Re Marriage, Neave & Co.* [1896] 2 Ch. 663 at 673.

⁴⁸ *MCC Proceeds Inc. v. Lehmann Bros.* [1998] 4 All E.R. 675 and *Carreras Rothmans v. Freeman Mathews Treasure* [1985] Ch. 207 at 227 respectively.

⁴⁹ There is no retransfer upon redemption in the case of charge since transfer is not involved in its creation (*De Beers Consolidated Mines v. British South Africa Co.* [1912] A.C. 52 at 69).

⁵⁰ [1997] B.C.C. 965 at 972.

⁵¹ [1997] B.C.C. 724 at 733C.

⁵² [1996] B.C.C. 613.

⁵³ *ibid.* at 618 per Millett L.J.

⁵⁴ *De Beers Consolidated Mines v. British South Africa Co.* [1912] A.C. 52 at 69.

⁵⁵ [1996] B.C.C. 613 at 619D.

⁵⁶ For when terms will be implied into contracts see generally e.g. Beatson, *Anson's Law of Contract* (27th ed., Oxford University Press, 1998), pp. 143-156.

⁵⁷ [1996] B.C.C. 613 at 615 and 618.

⁵⁸ [1913] 2 K.B. 515.

or chargor/chargee relationship is proprietary.⁵⁹ In *Royal Trust Bank*, Brookes' agency was merely ancillary to the mortgage. Nourse L.J.'s analysis,⁶⁰ that in the absence of a trust obligation to keep the property *in specie* there is a duty to account, empties the security relationship of its proprietary character. In fact, Lord Eldon settled this point nearly 200 years ago in *Nutbrown v. Thornton*⁶¹ where he acceded to an application by a mortgagor to have the mortgaged assets which had been seized by the mortgagee returned to the mortgagor for the express purpose of allowing the mortgagor to deal with them. Lord Eldon refused in terms to require the mortgagor to keep the assets *in specie*, holding that *Fells v. Read*⁶² was inapplicable. This is a feature of many of the cases cited in the Appendix to this article.⁶³

- (4) The Court of Appeal found that Royal Trust's notice to National Westminster (not sent to Brookes) of its interest in the debts was insufficient to give Royal Trust priority over the set-off by National Westminster. In the case of a mortgage this would have been sufficient.

As has been stated, at the time of *Yorkshire Woolcombers* itself there was no public registration requirement for specific securities over book debts. Floating charges though were subject to public registration. In a climate where fraud and unconscionable conduct by company participators was common, it is no great surprise that the courts were keen to find that, what was expressed to be an assignment of book debts, on the facts constituted a floating charge. The Court of Appeal in *Yorkshire Woolcombers* specifically quoted a clause in the security agreement, which is quoted as point (c) in the introduction to this article. The clause contains an express reference to dealing and could be prayed in aid of the courts' conclusion that the charge floated. In the authors' view, the clause is no more than an exemption clause and may be regarded as unusual, given the circumstances in which the agreement was executed. In the context of the agreement it is not surprising that the trustees would not wish to be made liable for allowing the company to carry on trading.

"... it is quite clear that anything which may take effect as a floating security is wholly inconsistent with, and is the antithesis of, a specific security".⁶⁴

Farwell J.'s view that a floating charge is the antithesis of a fixed charge has usually been taken by company lawyers in conjunction with Romer L.J.'s three characteristics of a floating charge:

"(1.) If it is a charge on a class of assets of a company present and future; (2.) if that class is one which, in the ordinary course of the business of the company, would be changing from time to time; and (3.) if you find that by the charge it is contemplated that, until some future step is taken by or on behalf of those interested in the charge, the company may carry on its business in the ordinary way as far as concerns the particular class of assets I am dealing with."⁶⁵

Thus, the present expositions of the book debt charge law often start with an acceptance of Romer L.J.'s characteristics and assume that a fixed charge must have the opposite characteristics. Hence Dr Gough considers it a "conceptual impossibility"⁶⁶ to postulate a fixed charge unless specific consent to the disposal of any specific item of charged property is forthcoming from the fixed chargee.

The book debt charge cases⁶⁷ probably represent the most sustained application of Farwell J.'s antithesis point—the floating charge subsisting in Romer L.J.'s terms and the fixed charge exhibiting none of the relevant characteristics.

This approach was erroneous in 1903 and is, in the authors' view, no better today. The apparently antithetical characteristics referred to were laid down without any analysis or citation of authority.⁶⁸ This is unfortunate because had any of the cases cited in the Appendix to this article been taken into account, it would have been overwhelmingly clear that much of what passes for the characteristics of the floating charge was present in future personalty mortgages and had been for a very long time prior to 1903.

It is the authors' submission that Farwell J. was correct to describe fixed and floating charges as antithetical. The issue, however, is: what matters are antithetical?

⁵⁹ For a recent informed discussion see *Wily v. St George Partnership Banking* [1999] B.P.I.R. 1030 (Fed.Ct.Aus.).

⁶⁰ [1996] B.C.C. 613 at 615G.

⁶¹ (1804) 10 Ves. Jun. 159.

⁶² (1796) 3 Ves. 70.

⁶³ See e.g. *Hutton v. Cruttwell* (1852) 22 L.J.Q.B. 78; *Joseph v. Lyons* (1884) 15 Q.B.D. 280 and *Re Neal* [1914] 2 K.B. 910. An early example is *Ryall v. Rolle* (1749) 1 Atk. 165 where it was accepted that the mortgaged stock in trade underwent several changes.

⁶⁴ [1903] 2 Ch. 284 at 289 per Farwell J.

⁶⁵ *ibid.* at 295.

⁶⁶ Gough, *Company Charges* (2nd ed., Butterworths, London, 1996), p. 368.

⁶⁷ See e.g. *Chalk v. Kahn* (February 29, 2000, unreported); *Re ASRS Establishment Ltd*, *The Times*, November 17, 1999; *Re Brumark Ltd* [1999] N.Z.C.A. 227; *Re Westmaze Ltd* [1999] B.C.C. 441; *Re Double S Printers Ltd* [1999] B.C.C. 303; *Royal Trust Bank v. National Westminster Bank plc* [1996] B.C.C. 613; *Re New Bullas Trading Ltd* [1994] B.C.C. 36; *Re Brightlife Ltd* [1987] Ch. 200; *Re Brightlife Ltd* [1987] Ch. 200; *Re Keenan Bros Ltd* (1986) 2 B.C.C. 98, 970 *Re Armagh Shoes Ltd* (1984) B.C.L.C. 405; *Siebe Gorman & Co. Ltd v. Barclays Bank Ltd* [1979] Lloyd's Rep. 142.

⁶⁸ See also Watts, "Fixed Charges Over After-Acquired Assets Outside the PPSA Regime" 5 *Banking & Finance Law Review* (NZ) 208 at 210.

The answer does not reside in Romer L.J.'s three characteristics because the future personalty mortgage cases are too numerous and flatly contrary to such a notion. This approach has arisen partly because Professor Pennington⁶⁹ and Professor Goode⁷⁰ found the development of the floating charge upon an analogy with the Roman Law *hypotheca*. The authors' dissent from this approach is that a mortgage is not and cannot be a charge—since the former involves title and the latter does not.

A further oddity in this area of law is that at the time of the creation of the floating charge, the greatest champions of equity's new *hypotheca* such as Jessel M.R.,⁷¹ Giffard⁷² and James⁷³ L.JJ. and Lord Lindley⁷⁴ were perfectly content to accept bills of sale granting future personalty mortgages where the assets changed in the ordinary course of business. In *Re Rees*⁷⁵ even Lord Macnaghten was seemingly untroubled by the concept.

It is a feature of the cases which produced the floating charge that future personalty mortgage decisions were rarely cited.⁷⁶ The probable explanation for this is that the courts were initially asked to determine the effect of a charge over the company's "undertaking", a device borrowed from the Companies Clauses Consolidation Act 1845.⁷⁷ The term "undertaking" did not appear in future personalty mortgages. It includes the right to carry on business, something which did not pass under a bill of sale.

In our submission:

- (a) the fixed charge is the antithesis of the floating charge;
- (b) the antithesis does not reside in the dealing power, which was express or implied in the old bills of sale mortgages—there was no less of an implied dealing power with the mortgage than there is with the floating charge;
- (c) if the floating charge was being compared with a mortgage, then the antithesis resides in the fact that the mortgagee has a title and the floating chargee does not;
- (d) the mortgagee has the remedy of foreclosure and the floating chargee does not;
- (e) the floating chargee, subject to exceptions, can only intervene on crystallisation whereas the mortgagee was not usually so limited;
- (f) on redemption the mortgagee has to make a re-transfer (unless the mortgage is in the form of a sale subject to defeasance on payment) whereas there is nothing to re-transfer in the case of a charge;
- (g) the antithesis does not reside in questions of possession;
- (h) the floating charge was an accretion to the range of equitable security devices and did not subtract the equitable future personalty mortgage from that range.

"...what you do require to make a specific security is that the security whenever it has once come into existence, and been identified or appropriated as a security, shall never thereafter at the will of the mortgagor cease to be a security. If at the will of the mortgagor he can dispose of it and prevent its being any longer a security, although something else may be substituted more or less for it, that is not a 'specific security'."⁷⁸

The chargor's right to use the proceeds of debts in the ordinary course of business (with or without the words "for its own account") is often described as the badge of a floating charge.⁷⁹ It is not clear why this is the case. There seems to be some assumption that by carrying on business and disposing of an asset, the debtor is doing an act inimical to the concept of specific security. This assumption has no foundation. As Erle J. said in *Bittlestone v. Cooke*⁸⁰ in 1853:

"There often may be a very good reason for taking a security over the whole of a trader's stock present and future, as then the stock may be used in the meantime and make a source of profit, whilst, if a portion of the existing stock is separated and set aside as a security, it is tied up from use."

⁶⁹ "The Genesis of the Floating Charge" (1960) 23 M.L.R. 630.

⁷⁰ "The Exodus of the Floating Charge" in Feldman and Meisel (eds.), *Corporate and Commercial Law: Modern Developments* (Lloyds of London Press, 1996), p. 193 at p. 195.

⁷¹ See *Re Borough of Hackney Newspaper Co.* (1876) 3 Ch.D. 669; *Collyer v. Isaacs* (1881) 19 Ch.D. 342; *Ford v. Kettle* (1882) 9 Q.B.D. 139; *Ex p. Popplewell* (1882) 21 Ch.D. 73 and *Ex p. Blaiberg* (1883) 23 Ch.D. 254.

⁷² See *Alton v. Harrison* (1869) 4 Ch.App. 622 and *Allen v. Bonnett* (1870) 5 Ch.App. 577.

⁷³ See *Ex p. Cohen* (1871) 7 Ch.App. 20, *Ex p. King* (1876) 2 Ch.D. 256; *Ex p. Ellis* (1876) 2 Ch.D. 797; *Ex p. Wright* (1876) 3 Ch.D. 70; *Ex p. Attwater* (1877) 5 Ch.D. 27; *Ex p. Fletcher* (1877) 5 Ch.D. 809; *Ex p. Games* (1879) 12 Ch.D. 314 (also included Thesiger L.J.); *Re Phillips* (1880) 16 Ch.D. 104.

⁷⁴ See *Walker v. Clay* (1880) 49 L.J.Q.B. 560; *Ford v. Kettle* (1882) 9 Q.B.D. 139; *Ex p. Popplewell* (1882) 21 Ch.D. 73; *Ex p. Blaiberg* (1883) 23 Ch.D. 254.

⁷⁵ [1894] A.C. 135.

⁷⁶ A rare example is the Irish case *Re Dublin Drapery Co.* (1884) I.R. 13 Ch.D. 174.

⁷⁷ See (1897) 13 L.Q.R. 418 at 420.

⁷⁸ [1903] 2 Ch. 284 at 294 *per* Vaughan Williams L.J.

⁷⁹ See *e.g. Re Brightlife Ltd* [1987] Ch. 200 at 209 *per* Hoffmann J.

⁸⁰ (1853) 23 L.J.Q.B. 78 at 80.

In *Taylor v. Bank of New South Wales*⁸¹ a farmer mortgaged his stock of sheep and the produce of them and continued to trade with the mortgaged flock. In considering the terms of the mortgage, Lord Watson commented, "all persons who relied upon its provisions, must be held to have contemplated that, so long as the mortgagor remained in possession, there would be sales from time to time, in the course of due administration, of portions of the mortgaged property . . . but the management of the sheep stock was still with the mortgagor, and, until the bank put an end to his management, he was entitled to deal with the stock in the ordinary course of his business as a sheep farmer".⁸²

The House of Lords in *Tailby v. Official Receiver*⁸³ held that a mortgage of future debts from any business that might be carried on by the mortgagor was not too vague and, following *Holroyd*, became effective as and when debts arose without the need for *novus actus*. Lord Fitzgerald, however, refused to decide the case because the parties were mooting. In fact the handwritten copy of his judgment in the House of Lords' records gives rather more illumination to the case than the Law Reports' omission of much of it. In the author's view the Official Receiver should have succeeded on Lord Fitzgerald's analysis and the printed case in Lincoln's Inn.

Izon, the mortgagor, borrowed two sums of £800 in 1879 and 1880 because he had to meet instalments becoming due under a composition. The 1879 mortgage, in fairly standard form, covered present and future personalty; the 1880 mortgage existing personalty only. Izon subsequently bought and dealt in timber and carried on manufacturing using the mortgaged property. He was adjudicated bankrupt in January 1885.

On November 14, 1884 the mortgagee's executors sought the final payment due of £122, took possession 15 minutes later under the 1880 deed, when Izon failed to pay, and sold furniture and stock to Tailby. The recitals to a contract between the executors and Tailby of November 15 record the fact of the sale of furniture for £70 and stock for £110 to Tailby the previous day. The contract itself is an agreement to assign certain book debts covered by the 1879 deed. Lord Fitzgerald considered this significant because the debts in question arose after the 1880 mortgage deed which did not cover future property. In the contract of November 15, therefore, the executors fall back on the 1879 deed.

The difficulty, as Lord Fitzgerald points out, is that the demand for £122 is fully paid by the mortgagees' receipt of £180 acknowledged in the recitals of November 15 for furniture and stock. At that point the debts are paid, the securities are fully satisfied and the mortgagees cannot agree to assign to Tailby, under the authority of the 1879 mortgage, the subsequent arising debts. Tailby has no title because the mortgages were fully satisfied securities as a result of the sale of the furniture and stock on November 14 and the mortgagees could no longer give a good title to Tailby. Tailby therefore had no answer to the Official Receiver's claim to receive the debts.

Tailby is a graphic illustration of the bill of sale mortgage with express or implied dealing power in operation. Its natural ancestors are *Holroyd* and *Taylor* and the line of authority on such mortgages to which reference has already been made. The authors' view is that if *Holroyd*, *Taylor* and *Tailby* are authorities then *Yorkshire Woolcombers* is not one.

In future personalty mortgage cases prior to *Yorkshire Woolcombers* it is clear that in dealing with the subject matter of specific security the mortgagor was carrying out the express (or implied) terms of the mortgage itself.⁸⁴ On the analogy of trust cases the trustee, in actively managing the trust property, is doing what the trust requires. The fact that the composition of the assets changes constantly in the execution of the trust does not alter the nature of the beneficiaries' interest in them. The idea that the mortgagor, in dealing with the security, would be acting adversely to the mortgagee's rights has no basis in law because it was constantly decided that the mortgagor had express or implied power to deal in the course of business. Just as a trustee must pay for services or goods or property in order to manage the trust, so does a mortgagor in the future personalty mortgage cases. If the trustee spends more than he gets in so that the trust assets are depleted or exhausted, the beneficiaries must look to the personal credit of the trustee to cover any liability. *Powell on Mortgages*⁸⁵ makes this point with regard to mortgagees who allow their mortgagors to deal in the mortgaged assets.

The three main grounds of principle which lead the authors to disagree with Vaughan Williams L.J.'s dictum are:

⁸¹ (1886) 11 App.Cas. 596.

⁸² *ibid.* at 602.

⁸³ (1888) 13 App.Cas. 523.

⁸⁴ See e.g. *Nutbrown v. Thornton* (1804) 10 Ves. Jun. 159; *Hutton v. Cruttwell* (1852) 22 L.J.Q.B. 78; *Ex p. Games* (1879) 12 Ch.D. 314; *Walker v. Clay* (1880) 49 L.J.Q.B. 560; *Joseph v. Lyons* (1884) 15 Q.B.D. 280; *Hallas v. Robinson* (1884) 15 Q.B.D. 288 and *Re Neal* [1914] 2 K.B. 910.

⁸⁵ Coventry (ed.), *Powell, A Treatise on the Law of Mortgages* (6th ed., 1826), p. 42.

- (1) The enormous number of personalty mortgage cases (of which those cited in the Appendix to this article are just a fraction) where the mortgage with dealing power was held good.
- (2) The security was specific because the mortgagee could positively affirm that he had a title to each and every item caught by the security description. It is of the essence that this should be the case otherwise, for example, the order and disposition clauses from the Bankruptcy Act 1623 onwards would have been incapable of applying to such mortgages since, without a title, the mortgagee could not have been the "true owner". It is clear from a long line of authorities starting with *Ryall v. Rolle*⁸⁶ that the mortgagee was the true owner.
- (3) Dealing is not the result of a unilateral exercise of will on the part of the mortgagor. It is an essential consequence of the contract between the parties that this is what the mortgagor will do.

What is the floating charge?

We have already referred to Romer L.J.'s "description" of a floating charge's three characteristics⁸⁷ which allowed also for such a charge to exist even though all three were not present.⁸⁸ Certainly where a security document provides for the described things to happen, one might have a floating charge. If, however, the transaction were couched as a mortgage, the three characteristics would equally well summarise what was happening under a present and future personalty mortgage with express or implied dealing power and which by 1903 had been developing over the previous 500 years. The security instrument in *Yorkshire Woolcombers* was a mortgage.

The following passage from the judgment of Hutton J. (as he then was) in *Re Armagh Shoes Ltd*⁸⁹ is useful in that it encapsulates the current controversy over the legal nature of the floating charge. Hutton J. begins by considering a *dictum* of Buckley L.J. in *Evans v. Rival Granite Quarries Ltd*⁹⁰:

"... Buckley L.J. did state that: 'A floating security is not a specific mortgage of the assets, plus a licence to the mortgagor to dispose of them in the course of his business, ...' but the learned Lord Justice did not state that there can be a specific mortgage of the assets, together with a licence to the mortgagor to dispose of them in the course of his business, and that the licence will not convert the specific charge into a floating charge."⁹¹

Hutton J.'s view of *Evans* is virtually a denial of the notion of a specific security with a licence to deal as being either capable of separate existence or as anything other than a floating charge. In modern judgments no-one has sought to point out the existence and central importance of mortgage bills of sale in commercial financing when security expressed to be over the "undertaking" appeared in *Re Panama, New Zealand and Australian Royal Mail Co.*⁹²

One of the few writers who does consider these mortgages is Dr Gough in his magnificent work *Company Charges*.⁹³ He says that these mortgages "appeared in the early 1880's"⁹⁴ and suggests that "[i]n reality they appear to constitute early examples of floating charges not recognised as such at the time".⁹⁵ He concludes that the "bills of sale cases in the early 1880's may possibly be considered as an isolated, but short lived, attempt by the courts of law to develop the concept of a specific security over fluctuating stock in trade".⁹⁶ The difficulty with this view, if we may respectfully say so, is that these mortgages not only appeared in the early 1880s but also in the 1780s and the 1680s. In fact mortgages over stock in trade and debts appeared in the fourteenth and fifteenth centuries. We have written at length on these matters in a forthcoming article.

Once the real significance of the old mortgage bill of sale is understood, the confusion as to what a floating charge is disappears. The reason is that the charge in *Panama* over the "undertaking" was borrowed from the Companies Clauses

⁸⁶ (1749) 1 Atk. 165.

⁸⁷ See n. 65 above.

⁸⁸ [1903] 2 Ch. 284 at 295 where Romer L.J. states he is not "prepared to say that there will not be a floating charge within the meaning of the Act, which does not contain all three characteristics".

⁸⁹ [1984] B.C.L.C. 405.

⁹⁰ [1910] 2 K.B. 979 at 999.

⁹¹ [1984] 1 B.C.L.C. 405 at 415.

⁹² (1870) 5 Ch.App. 318.

⁹³ Gough, *Company Charges* (2nd ed., Butterworths, London, 1996).

⁹⁴ *ibid.* p. 369.

⁹⁵ *ibid.* p. 371.

⁹⁶ *ibid.* p. 372.

Consolidation Act 1845, where it was the prescribed form of mortgage. There is no question that in relation to companies to which the 1845 Act applied (public utilities incorporated by private Act of Parliament), that form of mortgage did not attach to anything until the company was wound up, abandoned its undertaking or ceased business.⁹⁷

When that form of security was borrowed for a Companies Act company, Giffard L.J.'s judgment in *Panama* suggests that the same legal state of affairs was produced except that the debenture holder could intervene upon default. Thus the future assets theory of the floating charge, preferred by Professor Pennington,⁹⁸ must be correct.

If something did happen in *Panama* in 1870—and it did—then the mortgage or charge over the undertaking (which is the fount of the floating charge) cannot be a specific charge with a licence to deal express or implied. The specific charge with a licence is in origin no more than a variant of the ancient mortgage bill of sale.

Now that the courts have reasserted the proposition that a charge does not confer title or possession,⁹⁹ the fixed charge on book debts is said to require that the bank account be under the control of the chargee.¹ Some of the expressions used in earlier cases look distinctly possessory and will have to be jettisoned.

The control test does, however, bring problems of its own:

- (1) Control, if exclusive, is the most important test of possession particularly in the context of a bank account. The bank has the legal title to the money representing the proceeds, the money is indistinguishable in the general mass of assets held by the bank and the bank has the right to determine whether or not to pay out on a cheque.
- (2) Control here largely resides in what steps the chargee takes in relation to the proceeds in the bank account. One consequence of this is that a charge is fixed only if it is policed adequately. Thus what the parties do about the charge agreement after execution is, or may become, decisive of the nature of the charge. In the result one cannot draft a fixed charge, one can only conduct it. In the authors' view this is an unwholesome infraction of the principle that post-contractual conduct should not be allowed to affect the meaning of the contract, a principle re-stated by the House of Lords in *Whitworth Street Estates Ltd v. Miller*² in 1970. Some book debt charge cases follow the *Whitworth* line.³
- (3) The control test is incompatible with criticism of Nourse L.J.'s judgment in *Re New Bullas (Trading) Ltd*.⁴ If policing is the key test of specific security over book debts, there can be no objection to a provision which says in effect: "If at the time the proceeds are paid in, we the chargees have not taken the steps necessary for control of the proceeds, then we will substitute a floating charge for the original specific charge", because:
 - (a) no rule forbids the parties to agree to substitute one form of charge for another;
 - (b) the indivisibility of the charge and its proceeds' argument misses the point in that the clause in *New Bullas* provides for the *termination* of the fixed charge at the same moment as the floating charge arises;
 - (c) it is logically indefensible in a contractual context to posit a rule that control is essential and at the same time posit a second rule which prohibits the parties from providing for what happens if they do, or do not, exercise that control, where the provision reflects precisely the consequences of the first rule.
- (4) If control and its exercise are the crux of a fixed charge, it appears that the nature of the charge can hop from fixed to floating status upon each occasion that the chargee exercises control or fails to do so. The inconvenient consequences of this to a person who takes a cheque from a company which has charged its book debts are obvious.

⁹⁷ See e.g. *Gardner v. London, Chatham and Dover Railway Co.* (1867) 2 Ch.App. 201. See also *Cross v. Imperial Continental Gas Association* [1923] 2 Ch. 553 which is also a case involving a private act utility.

⁹⁸ Pennington, *Company Law* (7th ed., Butterworths, London, 1995), pp. 567–569.

⁹⁹ See e.g. *Morris v. Agrichemicals Ltd* [1997] B.C.C. 965 at 972 per Lord Hoffmann.

¹ See e.g. *Siebe Gorman & Co. Ltd v. Barclays Bank Ltd* [1979] 2 Lloyd's Rep. 142.

² [1970] A.C. 583.

³ See e.g. *Re Wogan's (Drogheda) Ltd* [1993] 1 I.R. 157 and *Whitton v. ACN* (1996) 14 A.C.L.C. 1799.

⁴ [1994] B.C.C. 36.

Overdraft financing

In the classic case of a book debt charge to secure overdraft arrangements, in determining whether the charge is fixed or floating, the modern cases refer to the chargor having a right to use the proceeds in the course of business. There is a question whether this is the true analysis of the position. The authors would make the following points in relation to current account overdraft financing:

- (a) with an account current there is no debt until the line is drawn on the account;
- (b) the rule in *Clayton's Case*⁵ applies so that a payment into the account is set against the earliest extant debit entry on the account;
- (c) it follows that a payment in discharges *pro tanto* the amount of the earliest extant debit entry;
- (d) the payment is, therefore, applied in reduction of the secured creditor's debt;
- (e) any further drawings on the account are new lending;
- (f) the suggestion that it is the proceeds of the book debts which are being used by the chargor is, therefore, misconceived.

Commercial realities

In the commercial context it is clear that those who provide loan capital on the security of, *inter alia*, personal property turned over in trade are looking for three things:

- (1) a security which will catch the borrower's existing and future property;
- (2) the continuance of the borrower's trade using the assets comprised in the security since the lender looks to the borrower to make income from trade in order to pay the debt: and
- (3) if the borrower subsequently fails, the security will cover the assets which the borrower has at the time of failure.

The floating charge meets those requirements. In practice, however, the requirements of the banks and money lending houses in previous centuries were similar to those which modern banks have and the Chancery Court did everything in its power to promote them. Hence the *dicta* about not letting mortgages stop trade dealings and the willingness of equity courts to construe personalty mortgages as permitting dealings⁶ or to imply a term to that effect.⁷

The commercial reason for the popularity of floating charges was nothing to do with trade paralysis. Rather it was the ban on future property security in the Bills of Sale Act 1882, which for a time enmeshed the corporate lending sector⁸ coupled with the surge in company registrations by those in business.⁹ In 1906 the Warrington Committee¹⁰ found no evidence that lenders did not get out under their floating charges, indeed the main complaint was the fact that they did.

The modern problem is that a succession of cases has placed burdens on the floating chargeholder's security which were not felt in the early days and the floating charge is now a commercially weak security. The pressure of *Romalpa* clauses, the implications of *Re Portbase Clothing Ltd*,¹¹ modern forms of asset financing and the size of preferential claims¹² have *inter alia*, exposed shortcomings from the lender's point of view.

If the banks and their customers prefer specific security of the kind contained in the future personalty mortgage cases (which often included debts¹³) they should be entitled to have it.

⁵ (1816) 1 Mer. 585. It may be possible for a bank, if the company does not exercise its power to appropriate payments in, to exercise its power to appropriate payments in to cover existing debts in an order different to that imposed by the application of *Clayton's Case* (see e.g. *Re Hallett's Estate* (1880) 13 Ch.D. 696 at 728 and 738).

⁶ e.g. Lord Hardwicke in *Ryall v. Rolle* (1749) 1 Atk. 165.

⁷ e.g. Lord Eldon in *Nutbrown v. Thornton* (1804) 10 Ves. Jun. 159.

⁸ See e.g. *Jenkinson v. Brandley Mining* (1887) 19 Q.B.D. 568.

⁹ Figures provided by Companies House show that company registrations virtually doubled decade on decade from the 1870s to the 1890s.

¹⁰ Report of the Company Law Amendment Committee 1906 (Cd. 3052).

¹¹ [1993] B.C.C. 96.

¹² See e.g. Keay and Walton, [1999] 3 Insolv.L. 112.

¹³ See *Re Neal* [1914] 2 K.B. 910 for an example of an effective mortgage of book debts (post *Yorkshire Woolcombers*) where the mortgagor retained the order and disposition of the debts for four years.

Appendix (see Footnote 16)

Meggott v. Mills (1697) 1 Ld. Raym. 286
Bucknal v. Roiston (1709) Prec. in Ch. 285
Bourne v. Dodson (1740) 1 Atk. 155
Brown v. Heathcote (1746) 1 Atk. 160
Ryall v. Rolle (1749) 1 Atk. 165
Worseley v. Demattos (1758) 1 Burr. 467
Wilson v. Day (1759) 2 Burr. 827
Hassells v. Simpson (1785) 1 Doug. 89
Edwards v. Harben (1788) 2 T.R. 587
Estwick v. Caillaud (1793) 5 T.R. 420
Nuthbrown v. Thornton (1804) 10 Ves. Jun. 160
Steel v. Brown (1808) 1 Taunt. 381
Robinson v. MacDonnell (1816) 5 M. & S. 228
The Ship Warre (1817) 8 Price 271
Curtis v. Auber (1820) 1 Jac. & W. 526
Balme v. Hutton (1828) 2 Y. & J. 101
Douglas v. Russell (1831) 4 Sim. & Stu. 524
Martindale v. Booth (1832) 3 B. & Ad. 498
Gardner v. Lachlan (1833) 6 Sim. 407
Carr v. Burdiss (1834) 1 C.M. & R. 443
Leslie v. Guthrie (1835) 1 Bing N.C. 697
Davenport v. Whitmore (1836) 2 My. & Cr. 521
Langton v. Horton (1842) 1 Hare 549
Tapfield v. Hilman (1843) 6 Man. & G. 245
Lindon v. Sharp (1843) 6 Man. & G. 895
Lunn v. Thornton (1845) 1 C.B. 379
Bradley v. Copley (1845) 1 C.B. 685
Gale v. Burnell (1845) 7 Q.B. 850
Petch v. Tutin (1846) 15 M. & W. 110
Fenn v. Bittlestone (1851) 7 Ex. 152
Ex p. Sparrow (1852) 2 De G.M. & G. 907
White v. Morris (1852) 21 L.J.C.P. 185
Brierley v. Kendall (1852) 21 L.J.Q.B. 161
Young v. Waud (1852) 22 L.J.Ex. 27
Hutton v. Cruttwell (1852) 22 L.J.Q.B. 78
Graham v. Chapman (1852) 12 C.B. 85
Smith v. Cannan (1853) 2 El. & Bl. 35
Congreve v. Evetts (1854) 23 L.J.Ex. 273
Stanger v. Wilkins (1855) 19 Beav. 626
Weaver v. Joule (1857) 3 C.B. (N.S.) 309
Carr v. Allatt (1858) 27 L.J.Ex. 385
Harris v. Rickett (1859) 28 L.J.Ex. 197
Guion v. Trask (1860) 1 L.T. (N.S.) 469
Ex p. Cottrell (1860) 1 L.T. (N.S.) 465
Pennell v. Reynolds (1861) 11 C.B. (N.S.) 709
Holroyd v. Marshall (1862) 10 H.L.C. 191
Toms v. Wilson (1862) 4 B. & S. 442
Brighty v. Norton (1862) 3 B. & S. 305
Reeve v. Whitmore (1863) 33 L.J. Ch. 63
Maugham v. Sharpe (1864) 17 C.B. (N.S.) 443
Belding v. Read (1865) 3 H. & C. 955
Young v. Fletcher (1865) 3 H. & C. 732
Re Colemere (1865) 1 Ch. App. 128
Mercer v. Peterson (1867) 2 Ex. 304
Richard v. James (1867) 2 Q.B. 285
Boyd v. Shorrock (1867) 5 Eq. 72
Massey v. Sladen (1868) 4 Ex. 13
Ex p. Foxley (1868) 3 Ch. App. 515
Alton v. Harrison (1869) 4 Ch. App. 622
Allen v. Bonnett (1870) 5 Ch. App. 577
Marks v. Feldman (1870) 5 Q.B. 275
Lomax v. Buxton (1871) 5 C.P. 107
Ex p. Cohen (1871) 7 Ch. App. 20
Begbie v. Fenwick (1871) 7 Ch. App. 1075
Thompson v. Cohen (1872) 7 Q.B. 527
Wulff v. Jay (1872) 7 Q.B. 756
Ex p. Fisher (1872) 7 Ch. App. 636
Ex p. Mutton (1872) 14 Eq. 178
Smale v. Burr (1872) 8 C.P. 64
Hawtry v. Butlin (1873) 8 Q.B. 290
Ex p. Dalglish (1873) 8 Ch. App. 1072
Ex p. Winder (1875) 1 Ch.D. 290
Greenbirt v. Smee (1876) 35 L.T. (N.S.) 168
Ex p. King (1876) 2 Ch.D. 256
Ex p. Ellis (1876) 2 Ch.D. 767
Re Wright (1876) 3 Ch.D. 70
Re Barrand (1876) 3 Ch.D. 324
Re Borough of Hackney Newspaper Co. (1876) 3 Ch.D. 669
Re Eslick (1876) 4 Ch.D. 496
Karet v. Kosher Meat supply Assoc (1877) 2 Q.B.D. 361
Ex p. Attwater (1877) 5 Ch.D. 27
Ex p. Fletcher (1877) 5 Ch.D. 809
Ex p. M'hattie (1878) 10 Ch.D. 398
Leatham v. Amor (1878) 47 L.J.Q.B. 581
Ex p. Games (1879) 12 Ch.D. 314
Ex p. Carter (1879) 12 Ch.D. 908
Ex p. Burton (1879) 13 Ch.D. 102
Boldero v. London and Westminster Loan and Discount Co. (1879) 5 Ex.D. 47
National Mercantile Bank Ltd v. Hampson (1880) 5 Q.B.D. 177
Walker v. Clay (1880) 49 L.J.Q.B. 560
Taylor v. M'Keand (1880) 49 L.J.Q.B. 563
Re Phillips (1880) 16 Ch.D. 104
Lazarus v. Andrade (1880) 5 C.P.D. 318
Hamlyn v. Betteley (1880) 5 C.P.D. 327
Ex p. Dann (1881) 17 Ch.D. 26
Collyer v. Isaacs (1881) 19 Ch.D. 342
Payne v. Fern (1881) 6 Q.B.D. 620
Ford v. Kettle (1882) 9 Q.B.D. 139
Ex p. Popplewell (1882) 21 Ch.D. 73
Clements v. Matthews (1883) 11 Q.B.D. 808
Ex p. Blaiberg (1883) 23 Ch. D. 254
Moore v. Shelley (1883) 8 App.Cas. 285
Ex p. Johnson (1884) 26 Ch.D. 338
Roberts v. Roberts (1884) 13 Q.B.D. 794
Joseph v. Lyons (1884) 15 Q.B.D. 280
Hallas v. Robinson (1884) 15 Q.B.D. 288
Taylor v. Bank of New South Wales (1886) 11 App.Cas. 596
Re Clarke (1887) 36 Ch.D. 348
Thomas v. Kelley (1888) 13 App.Cas. 506
Wigram v. Buckley [1894] 3 Ch. 483
Seed v. Bradley [1894] 1 Q.B. 319
Re Rees [1894] A.C. 135
Rutter v. Everett [1895] 2 Ch. 872
Coates v. Moore [1903] 2 K.B. 140
Re Neal [1914] 2 K.B. 910

PARTNERSHIP FLOATING CHARGES OPENING A CAN OF WORMS?

Peter Walton¹

In their recent Joint Consultation Paper on Partnership Law² the Law Commission and Scottish Law Commission (hereafter “the Law Commission”), in proposing that a partnership which chooses to be registered centrally will have a legal personality separate from its partners, considered also whether such a partnership should be allowed to grant a floating charge over its assets.³ At first blush, this seems a sensible proposal in that if a registered company with separate personality from its members can execute floating charges, why should not a partnership with similar attributes? Indeed a similar suggestion was made during the evidence taken by the Davey Committee⁴ in 1895: “I see no objection to either a company or an ordinary trader or partnership borrowing money upon a floating charge of the stock in trade or general assets of the business...”⁵

Partnerships at present cannot create floating charges because the Bills of Sale Act (1878) Amendment Act 1882 prevents firms (and individuals) from executing

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² Law Commission for England and Wales and Scottish Law Commission “Partnership Law” A Joint Consultation Paper (2000) No. 159 (Hereafter “Law Commission Consultation Paper”).

³ *Ibid.* Part XXII Floating and other Charges at para. 22.27.

⁴ Report of the Departmental Committee Appointed by the Board of Trade to Inquire what Amendments are necessary in the Act relating to Joint Stock Companies Incorporated with Limited Liability (1895) C.7776

⁵ *Ibid.* Appendix p.69 statement by a Mr Samuel Ogden.

securities over future property.⁶ The Law Commission's proposal is to make registered partnerships exempt from the 1882 Act and so free them to create floating charges.⁷ A new system of security registration based upon the current charges registration requirements for companies under the Companies Act is also suggested.⁸

The Law Commission seems to assume that, once free of the restrictions of the Bills of Sale Act 1882, partnerships will be able and willing to create floating charges. This assumption is disconcertingly unequivocal in that the Law Commission does not appear to have considered the type of security partnerships gave for their borrowings prior to the introduction of the 1882 Act. If partnerships did not at that time execute floating charges, and they did not, would the new registered partnership not merely adopt the secured lending mechanisms that partnerships used before 1882 and ignore the possibility of a floating charge? This would be particularly likely if the previous form of secured lending would today provide a better security for the lender than a floating charge.

Business financing activity at the end of the nineteenth and beginning of the twentieth centuries provoked several policy considerations of what types of secured lending should be permitted and what form such lending should take both for incorporated and unincorporated business media. An examination of what occurred in this period is crucial in understanding why the law on corporate secured lending is how it is today, and may point the way forward as to how incorporated partnership lending may evolve. As Professor Goode has stated, commercial law developments are a response to commercial needs.⁹ The commercial needs today may not be identical to those of a hundred or two hundred years ago but they are sufficiently similar to suggest that future commercial law developments may well mirror the efficient lending mechanisms from that period.

⁶ See ss.5 and 9. See also *Thomas v. Kelly* (1888) 13 App Cas 506. For an explanation of how this restriction operates and for an argument that it still permits partnerships to execute a limited form of floating charge see Fitzpatrick "Why Not a Partnership Floating Charge?" [1971] JBL 18.

⁷ Law Commission Consultation Paper Part XXII para. 22.27 at footnote 56.

⁸ *Ibid.* at paras. 22.20-22.21. The system of registration of company charges is currently once again being examined by the Government. The Steering Group of the Company Law Review established by the Department of Trade and Industry has recently issued its seventh consultation document in its *Modern Company Law for a Competitive Economy* series entitled *Registration of Company Charges*.

⁹ "The Exodus of the Floating Charge" in *Corporate and Commercial Law: Modern Developments* (ed. Feldman and Meisel) London, 1996, at p.193.

There is more than one reason that the limited liability company became so popular in the twentieth century. Limited liability was clearly one of them but the ability to secure borrowing over changing assets by executing a floating charge was also significant. The purpose of this article is to attempt to predict, in light of certain historical facts, what effect the specific proposal of the Law Commission to release partnerships from the Bills of Sale Act 1882 would actually have in practice. It will be suggested that if the Law Commission's proposals were extended to limited liability partnerships¹⁰ this could lead to a widespread rejection by the business community of limited liability companies in favour of limited liability partnerships.

The Current Debate Over Fixed and Floating Security

Much has been written on the nature of the floating charge and how it differs from a fixed charge.¹¹ *Re Florence Land and Public Works Co*¹² sowed the seeds, and the accepted wisdom on the distinction between fixed and floating charges came into full bloom in the *Yorkshire Woolcombers*¹³ case. It is in modern days generally accepted that if a company gives a charge over assets which by their nature change day to day then the charge must float as the chargee does not have possession or control over the charged assets.¹⁴ If the assets can be alienated only with the consent of the chargee then the charge will normally be fixed.¹⁵ Some

¹⁰ This is possible under section 15 of the Limited Liability Partnerships Act 2000 and it is submitted is likely to happen if the Law Commission proposal is adopted for registered partnerships without limited liability.

¹¹ See e.g. Pennington "The Genesis of the Floating Charge" (1960) 23 MLR 630 and "Fixed Charges over Future Assets of a Company" (1985) 6 Co Lawyer 9, Farrar "Floating Charges and Priorities" (1974) 38 Conv 315 and "The Crystallisation of a Floating Charge" (1976) 40 Conv 397, Ferran "Floating Charges-The Nature of the Security" [1988] CLJ 213, Worthington "Floating Charges -An Alternative Theory" [1994] CLJ 81, Gregory and Walton "Fixed Charges over Changing Assets - The Possession and Control Heresy" (1998) 2 CfiLR 68 and "Book Debt Charges: Following *Yorkshire Woolcombers* - Are We Sheep Gone Astray?" [2000] Insolvency Lawyer 157.

¹² (1878) 10 ChD 530.

¹³ *Re Yorkshire Woolcombers' Association Ltd* [1903] 2 Ch 284, High Court and Court of Appeal decisions reported together. The House of Lords adopted both courts' decisions *sub nom. Illingworth v Houldsworth* [1904] AC 355.

¹⁴ See e.g. Gregory and Walton "Book Debt Charges - the Saga Goes On" (1999) 115 LQR 14, *Re Armagh Shoes Ltd* (1984) 1 BCLC 405, *Re Double S Printers Ltd* [1999] BCC 303, *Re Westmaze Ltd* [1999] BCC 441, *Re ASRS Establishments Ltd* [2000] 1 BCLC 727, *Chalk v Kahn* [2000] 2 BCLC 361.

¹⁵ See e.g. *Siebe Gorman & Co Ltd v Barclays Bank Ltd* [1979] 2 Ll Rp 142.

restriction on the power to alienate will not necessarily make the charge fixed¹⁶ and some ability to alienate the charged property will not necessarily mean the charge floats.¹⁷

No modern attempt has been made to uphold a fixed charge over stock in trade but fixed charges over book debts have, since the 1979 decision in *Siebe Gorman & Co Ltd v Barclays Bank Ltd*,¹⁸ become common where the debenture holder controls the chargor company's bank account into which the book debts are paid. Even if the debenture holder is not the clearing bank a hybrid type of charge which permits the charge to be fixed whilst the debts are outstanding but which floats once the debts are paid, will be effective according to *Re New Bullas Trading Ltd*.¹⁹ The imminent arrival from New Zealand of *Re Brumark Investments Ltd*²⁰ in the Privy Council may lead to some certainty in this area. It is not inconceivable that their Lordships may tidy up the whole area by overruling both *Siebe Gorman* and *New Bullas* and decide that only fixed assets such as land and machinery can be subject to fixed security.²¹

In New Zealand there is now in place the Personal Property Securities Act 1999 ("the PPSA") which makes *Brumark* of little local consequence for the future.²² Control ceases to be the distinguishing feature under the PPSA, rather the type of asset being charged is the determining factor. This statutory result may be in effect the same as that which the Privy Council ends up with in *Brumark* if their Lordships remain rigidly loyal to *Yorkshire Woolcombers*.²³

¹⁶ See e.g. *Re Brightlife Ltd* [1987] Ch 200.

¹⁷ See e.g. *Re Cimex Tissues Ltd* [1994] BCC 626.

¹⁸ [1979] 2 LI Rep 142.

¹⁹ [1994] BCC 36.

²⁰ [2000] 1 BCLC 353.

²¹ See Picarda "Labels: A Voyage Round Fixed and Floating Charges" (2000) Vol. 4 Issue 2 RALQ 109 at p.136.

²² "It is to be noted that this long troubling distinction between fixed and floating charges will disappear from our law when the Personal Property Securities Act 1999 comes into force. Until then it must be grappled with." *Re Brumark Investments Ltd*. [2000] 1 BCLC 353 at 354 per Gault J.

²³ For a critical analysis of *Yorkshire Woolcombers* see Gregory and Walton "Book Debts Charges: Following Yorkshire Woolcombers - Are We Sheep Gone Astray?" [2000] Insolvency Lawyer 157.

The distinction between the two types of security is extremely important in practice due *inter alia* to the priority of fixed over floating charges, the preferential debts regime and the problems of *Re Portbase Clothing Ltd.*²⁴ It is unfortunate that the law in this area remains subject to doubt. It was noted by the High Court in 1988, in referring to company secured lending generally, that “this is a type of transaction in respect of which judicial precedent is a particularly valuable guide to the commercial adviser.”²⁵ This was perhaps true in 1988 but it would be overly optimistic for a commercial adviser today to rely too heavily on any particular current judicial precedent. If commercial advisors could be certain of being able to draft a simple and effective fixed security over changing assets, their professional lives would be made considerably more straightforward. The Law Commission’s proposal may be the first stepping stone across these hitherto turbulent waters.

How Partnerships Borrowed Prior to the Floating Charge

In considering that charges granted over assets of partnerships without separate personality were outside its terms of reference, the Law Commission accepted that such charges were “indistinguishable from that of security granted by individuals”.²⁶ One important and often overlooked question is, how did business secure finance prior to registered companies and the invention of the floating charge? The answer is very simple - the mortgage bill of sale. For centuries sole traders and partnerships borrowed money by mortgaging *inter alia* their stock in trade and book debts but retained the power to deal with such assets in the day to day administration of their business.

Security bills of sale expressly assigned the mortgagor’s present and future assets with a proviso for reassignment on payment of the debt. Such bills were not charges, which by definition involve no title or possession in the chargee.²⁷ The courts had no problem with the mortgagor being given a power (either express or implied) to deal with the mortgaged assets in the ordinary course of business.²⁸ Although it is impossible to assign future property as such, equity regards a covenant to assign future property as effective as soon as the assets come into

²⁴ [1993] BCC 96.

²⁵ *Re a Company, ex parte Copp* [1989] BCLC 13 at 25 *per* Knox J.

²⁶ Law Commission Consultation Paper Part XXII at para. 22.14.

²⁷ See e.g. *Morris v Agrichemicals Ltd* [1997] BCC 965 at 972 *per* Lord Hoffman.

²⁸ See e.g. *Walker v Clay* (1880) 49 LJQB 560 and *Payne v Fern* (1881) 6 QBD 620.

existence under the maxim "equity looks upon that as done which ought to be done". As assets changed from day to day the mortgage security merely attached to the new assets as soon as they came into existence.²⁹ This is the *ratio* of the House of Lords decision in *Holroyd v Marshall*³⁰ and of the majority of their Lordships in *Tailby v Official Receiver*.³¹ The bill of sale mortgage is a specific security which attaches as soon as assets within the terms of the mortgage come into the hands of the mortgagor. Such a mortgage by conferring an equitable title, did not and does not, paralyse the trade.

*Joseph v Lyons*³² involved a mortgage by a sole trader of all the goodwill of his business, all the current stock in trade and all future stock in trade. The Court of Appeal decided that no legal title to future stock passed to the mortgagee (there being no *novus actus* such as the mortgagee taking possession of the future property) but that the mortgage was valid in equity. The mortgage did not prevent the trader from continuing to turn over his stock in trade in the ordinary course of business for over two years. *Joseph v Lyons* has recently been approved by the Court of Appeal in *MCC Proceeds Inc v Lehmann Bros International (Europe)*.³³

Dr Gough in his excellent book *Company Charges*³⁴ suggests that the security in *Joseph v Lyons* was in reality a floating charge³⁵ and the case was incorrectly decided because the ability in the mortgagor "to appropriate stocks for the purposes of sale in the ordinary course of business would prevent appropriation necessary to cause the passage of an equitable as well as legal title."³⁶ In considering this criticism three points may be made: 1) the case dealt with a mortgage not a charge; 2) the security is specific not floating as the mortgagee has an equitable title to the goods mortgaged; and 3) the title is complete due to the equitable maxim and requires no further act by either party. The idea that some act, step or process amounting to appropriation is required to perfect the

²⁹ See e.g. *Ex parte Games* (1879) 12 ChD 314.

³⁰ (1862) 10 HLC 191.

³¹ (1888) 13 App Cas 523.

³² (1884) 15 QBD 280.

³³ [1998] 4 All ER 675.

³⁴ Gough *Company Charges* 2nd Ed (Butterworths, London 1996).

³⁵ *Ibid* at p. 371.

³⁶ *Ibid*.

security has no foundation in mortgage law. The proposed requirement for some form of appropriation of future stock suggests that the mortgaged property needs to be set aside in some way and not used by the mortgagor in the ordinary course of business.³⁷ This idea is contrary to scores of decisions which permit a mortgage containing a power in the mortgagor to deal with the mortgaged assets in the ordinary course.³⁸ It would certainly surprise Lord Hardwicke who in considering such a mortgage in 1749 stated that having executed the mortgage, the mortgagor "had it in his power to sell all the goods the next hour."³⁹

An example of a typical mortgage bill of sale from 1866 states that the mortgagor:

"assigned to the defendant the whole of his household goods, furniture, stock-in-trade and effects then upon, or which should thereafter be upon, his premises, and also his book debts, and all other the personal estate to which he was then or should (so long as any moneys remained payable to the defendant) at any time thereafter be entitled."⁴⁰

At this time the structure of bills of sale had changed little in a hundred years. In *Worseley v Demattos*⁴¹ in 1758 the mortgagor had mortgaged, *inter alia*, "all his stock, utensils, and other things, used in his trades of brewing and malting, and of a corn factor and miller; consisting of coppers, tuns, backs, coolers, pumps, cisterns, screens, and other implements; and also all his changeable stock, consisting of debts, horses, carts, casks, hops, beer, ale, wheat, barley, malt, coals, wood, and all other goods and commodities belonging, employed, or made use of, in the said several trades, or any of them; and all his estate, right, title, interest, property, claim, and demand whatsoever thereto, and to every or any part thereof."⁴²

³⁷ This idea bears comparison with the view of Henchy J in *Re Keenan Bros Ltd* (1986) 2 BCC 98,970 at 98,973 that assets subject to a fixed charge must be: "withdrawn from ordinary trade use, put in the keeping of the debenture holder and sterilised and made undisposible save at the absolute discretion of the debenture holder."

³⁸ See the cases listed in the Appendix to the article cited at footnote 23 above.

³⁹ *Ryall v Rolle* (1749) 1 Atk 165 at 183.

⁴⁰ *Mercer v Peterson* (1867) LR 2 Exch 304 at 306. See also cases listed in the Appendix to the article cited at footnote 23 above.

⁴¹ (1758) 1 Burr 467.

⁴² *Ibid.* at 468-9.

There were several problems with mortgage bills of sale in practice. The most serious was that they were commonly used as an engine of fraud, namely that it was possible for a person to mortgage all his assets present and future but for the mortgage to remain secret. Only when, for example, a judgment creditor levied execution over the mortgagor's goods would the bill be held up and of course it took priority.⁴³

Upon bankruptcy the secret bill of sale was less effective due to the order and disposition clause in the Bankruptcy Acts.⁴⁴ Assets which were in the order and disposition of the bankrupt but which belonged to another, for example a mortgagee, who consented to the bankrupt's possession in the course of trade or business, were treated as part of the bankrupt's estate. It was commonly the case that assets were mortgaged and the mortgagor was allowed to continue to trade with them with the result that the mortgagee's security became worthless on the mortgagor's bankruptcy.

In *Lingham v Biggs*⁴⁵ in 1797 it was accepted that most of the cases on the order and disposition clause were cases involving mortgages.⁴⁶ In the same case, counsel put forward the proposition that the order and disposition clause "was not intended to interfere with any thing but the stock in trade, the possession of which necessarily implies the order and disposition, sale and alteration &c."⁴⁷ A mortgage of stock does allow the mortgagor to deal with the mortgaged assets in the ordinary course of business.

The Bills of Sale Act 1854 made bills publicly registrable with the intention of preventing fraudulent secret bills.⁴⁸ A further Bills of Sale Act of 1878 amended the registration requirements in various ways but importantly also released bills of sale from the shackles of the order and disposition clause.⁴⁹ Moneylenders were quick to exploit this release and there was a consequent explosion in the

43 The priority point also depended upon a number of other issues. See generally *Holroyd* itself.

44 Introduced by ss.10 and 11 of 21 Jac 1 c.19 (the Bankruptcy Act 1623) and only repealed by the Insolvency Act 1985.

45 (1797) 1 Bos and Pul 82.

46 *Ibid.* at 88 *per* Eyre CJ.

47 *Ibid.* at 85 (statement by Adair Serjt).

48 See Fitzpatrick "Why Not a Partnership Floating Charge?" [1971] JBL 18 at p. 20.

49 Section 20.

number of bills of sale being executed. The problems caused by the 1878 Act were remedied by a further Act in 1882⁵⁰ in which bills of sale securing relatively small amounts were outlawed altogether⁵¹ and bills over future property generally prohibited.⁵²

The 1882 Act did much to kill off the bill of sale as an everyday security device. This was largely due to the prohibition on future property security but was also due to the uncertainty the courts expressed in attempting to make sense of some of the 1882 Act's provisions. Lord Macnaghten commented in 1888 that to say that the Act "is well-drawn, or that its meaning is reasonably clear, would be to affirm a proposition to which I think few lawyers would subscribe...it is beset with difficulties which can only be removed by legislation."⁵³ Uncertainty was the constant companion of bills of sale after 1882.

Some Interesting Figures

Although the author has been unable to trace how many bills were registered in the early years of the operation of the 1854 Bills of Sale Act some figures are contained within certain Parliamentary Papers.⁵⁴ These statistics contain no differentiation between security and absolute bills and so the figures are of limited use, but they do show some definite trends. In 1875 a total of 11,216 bills was registered with a total value of £2,123,000.⁵⁵ In 1877 the total was 13,220⁵⁶ and

⁵⁰ Bills of Sale Act (1878) Amendment Act 1882.

⁵¹ *Ibid.* section 12.

⁵² *Ibid.* sections 5 and 9. Instead of merely returning to the Order and Disposition clause the 1882 Act outlawed all bills over future property. The lesser step of repealing the order and disposition clause had been in the Bill at its second reading in the House of Commons (Hansard Col 397 8th March 1882) and had been supported by Mr Henry H Fowler, Member for Wolverhampton: "In 1878, what he was bound to call that foolish and disastrous Act was passed which repealed "the Order and Disposition" Clause" Hansard Col 1408-9 20th March 1882.

⁵³ *Thomas v Kelly* (1888) 13 App Cas 506 at 517.

⁵⁴ There are one or two discrepancies from different sources in terms of exact numbers but the differences are for present purposes *de minimis*.

⁵⁵ House of Commons Select Committee on Bills of Sale - British Parliamentary Papers 1881 (34) VIII.1 at paras. 12 and 13.

⁵⁶ Hansard HC Col 1401 20th March 1882.

in 1878 the total was 19,596.⁵⁷ By 1880 the total was 54,232 bills with a value of £4,333,000.⁵⁸ In 1880 only 416 of the registered bills were for sums over £1000 and it seems that many small bills for less than £15 were not registered at all.⁵⁹ There is a slight difference of opinion as to how many bills of sale were registered in the first decade of the twentieth century. The Principal Clerk in the Bills of Sale Registry of the Royal Courts of Justice at that time estimated the annual number to be between 8,000 and 10,000. A specific figure put forward for 1908 is 7,000 based upon perusal of weekly gazettes where registered bills were publicised.⁶⁰ Nowadays only about 3500-4000 bills of sale are registered and nearly all of these are car financing agreements.

It is clear from these figures that the removal of bills of sale from bankruptcy's order and disposition clause by the Bills of Sale Act 1878 had a huge impact in increasing the numbers of bills registered. The Bills of Sale Act 1882 did not reinstate the order and disposition clause to bills of sale but instead, with limited exceptions, prevented individuals and partnerships from executing bills of sale over future property.⁶¹ The 1882 Act consequently had an even more dramatic effect in reducing the number of bills of sale at a time when commerce generally was increasing. The upsurge in mortgage bills of sale after the 1878 Act was shortlived. The 1882 Act virtually killed off the mortgage bill of sale over changing assets.

Contemporary Comment on Future Property Bill of Sale Mortgages

In questioning witnesses the House of Commons Select Committee on Bills of Sale⁶² in 1881 confirmed how frequent future property mortgages had become by asking: "Of course you are aware it is a common form in bills of sale, in

⁵⁷ House of Commons Select Committee on Bills of Sale - British Parliamentary Papers 1881 (34) VIII.1 at para. 112.

⁵⁸ *Ibid.* at para. 111.

⁵⁹ Hansard HC Col 394 March 8 1882. See also the evidence given to the House of Commons Select Committee *ibid.* at para. 1029.

⁶⁰ Evidence to Committee Appointed by the Board of Trade to Inquire into the Bankruptcy Law and its Administration 1908 Cd. 4068 the "Muir-Mackenzie Committee" Volume II Appendices and Index at pp.232 and 301 respectively.

⁶¹ *Ibid* ss.5 and 9. The Act under section 12 also made void small bills of sale (for less than £30) to protect those least capable of protecting themselves.

⁶² British Parliamentary Papers 1881 (34) VIII.1.

pledging stock, to include stock which he has not yet purchased, and which has therefore to come in?"⁶³ In questioning a moneylender over the proposed prohibition on future property mortgages (given effect to by the 1882 Act) the following exchange took place "You think that would hamper very much the power of people in trade to borrow money legitimately for the purpose of their trade? - I believe they would not be able then to borrow money..."⁶⁴. Another moneylender⁶⁵ in discussion of relatively small bills of sale for £100 over the "floating stock" of tradesmen was asked what effect a prohibition on mortgages of after acquired property would have on such tradesmen's transactions. He responded: "It would stultify a great many of them."⁶⁶

In moving the Bill which became the 1882 Act reference was made to the Select Committee and the numerous judges who had given evidence and it was stated: "They agreed generally that after-acquired property should not pass under a bill of sale, and that the law, as laid down in "Holroyd and Marshall" by the House of Lords, should be altered."⁶⁷

Creditors' representatives before the House of Commons Select Committee regarded a bill of sale over floating stock as a fraud as it encouraged a mortgagor to obtain assets on credit which immediately became bound by the bill to the loss of creditors generally. Their opinion was either that after acquired property should not be permitted to be mortgaged at all or that if permitted the security should be limited to fixtures and machinery, things which the mortgagor was not intending to sell.⁶⁸ Similarly in debate in the House of Commons one Member: "... considered it unsound in principle that a trader should be able to give a preferential security to a particular creditor over goods which he might never pay

⁶³ *Ibid.* at para. 35 question put by Mr Serjeant Simon.

⁶⁴ *Ibid.* at para. 726 Mr BT Williams questioning a moneylender Mr William Usher.

⁶⁵ Although it would be dangerous to place too much reliance on the evidence of moneylenders at this period one member of the House of Commons later commented that their "...testimony was of the most graphic and sensational nature. He thought he had never read anything more sensational in Dickens's novels; but, in saying that, he must do those professed money-lenders the justice to say that nothing could be more frank, straightforward, and impartial than the manner in which they gave their evidence." Hansard HC Col 395 8th March 1882 comment of Mr Monk.

⁶⁶ British Parliamentary Papers 1881 (34) VIII.1 at para. 1184.

⁶⁷ Hansard HC Col 395 8th March 1882.

⁶⁸ See British Parliamentary Papers 1881 (34) VIII.1 at paras. 1374-1378, 1410-11, 1499, 1596 and 1764.

for...".⁶⁹

In addition to many relatively small traders giving all encompassing bills of sale to the detriment of their creditors generally, there had grown up a real social problem with moneylenders taking advantage of the 1878 Act to prey on small debtors from all walks of life.⁷⁰ Small bills had become a real problem. Lord Coleridge commented in Parliament that: "In 1877 the number of bills of sale under £50 was 4,802 in England, and the amount secured by them was £125,597. In 1880, the number was 38,177, and the sum secured £715,000. The smaller bills of sale given to money-lenders were undoubtedly very oppressive, and the interest exacted was often outrageous."⁷¹ Mr James Motteram QC, a Birmingham County Court judge, estimated in 1881 that between 80 and 90 per cent of all bills of sale were fraudulent.⁷²

Bills of sale subject to statutory registration are by definition⁷³ only capable of being executed over chattels. It is arguably no smaller a deception secretly to mortgage one's future book debts rather than one's future stock in trade. Book debts represent only stock in trade which has been or will be sold. Despite this the Bills of Sale Acts did not regulate mortgages of choses in action in general or of book debts in particular.⁷⁴

⁶⁹ Comment by Mr Lewis Fry, Hansard HC Col 402 8th March 1882.

⁷⁰ Evidence before the House of Commons Select Committee in 1881 included a list of the type of person who had executed bills of sale during a particular fortnight in the Nottingham area: "There is a fitter, butcher, widow, tailor, slater, labourer, widow, policeman, labourer, traveller (of what degree it does not specify), police constable, lacemaker, fitter, dry-salter, coal dealer, cowkeeper and farmer, miner, gardener, miner, fisherman, butcher and butter dealer, fitter, fishmonger, farmer, grocer and pleasure boat proprietor, dressmaker, tanner, beer-house keeper, joiner, widow, victualler, inn-keeper, shoemaker, lacemaker, blacksmith, boilersmith, market gardener, smith, householder, warehouseman, lodging-house keeper, contractor, &c., lacecutter, widow, framework-knitter, gardener, brushmaker, moulder, charwoman, farmer, groom, coaldealer, groom, builder, &c., labourer, platelayer, labourer, farmer and grazier, miner." British Parliamentary Papers 1881 (34) VIII.1 at para. 1172.

⁷¹ Hansard HL Col 1545 June 19 1882. The Attorney General of the time, Sir Henry James, had different and even more damning figures - 1877 total 13,000 bills, 1880 total 51,000 bills (Hansard HC Col 1401 20th March 1882).

⁷² British Parliamentary Papers 1881 (34) VIII.1 at para.1566.

⁷³ See Bills of Sale Act 1854 s.1 and Bills of Sale Act 1878 s.4.

⁷⁴ See e.g. *Tailby v Official Receiver* (1888) 13 App Cas 523 and *Re Neal* [1914] 2 KB 910.

Evidence before the Muir-Mackenzie Committee⁷⁵ in 1908 demonstrated that it was not infrequent for a general assignment of book debts to be taken which remained secret and, with the collusion of the mortgagor just prior to his bankruptcy, notice would be given to the debtors with the result that unsecured creditors would find themselves with nothing in the bankruptcy.⁷⁶ Secrecy of such assignments was of potential benefit to banks but the chairman of Lloyds Bank (who was also the President of the Institute of Bankers) recommended compulsory registration of general assignments of book debts. With an interesting mixture of imagery, he commented that the view of the "great banking houses" was "that all a man's cards should be on the table, and that he should not be sailing under false colours."⁷⁷

Following the recommendation of the Muir-Mackenzie Committee⁷⁸ a general assignment of present or future book debts was made subject to registration as an absolute bill of sale under the Bills of Sale Act 1878⁷⁹ by s.43 Bankruptcy Act 1914.⁸⁰

Companies Subject to Bills of Sale Acts?

Whether or not companies were subject to the Bills of Sale Acts was one of the great legal questions of the second half of the nineteenth century. It is clear that at one time companies executed bills in the same form as individuals and

⁷⁵ Committee Appointed by the Board of Trade to Inquire into the Bankruptcy Law and its Administration 1908 Cd. 4068.

⁷⁶ *Ibid.* Volume II Appendices and Index at para. 2364.

⁷⁷ *Ibid.* at para. 4601

⁷⁸ *Ibid.* at para. 151.

⁷⁹ Not a security bill under the 1882 Act as presumably this would be impossible by virtue of the future assets rule in s.5 and could not be in the statutory form as required by s.9 and the Schedule to the Act.

⁸⁰ See now Insolvency Act 1986 s.344.

partnerships.⁸¹ It is also clear that at least some companies took the precaution of registering their securities.⁸²

The point became a very live issue after the 1882 Act outlawed mortgages over present and future property. Section 17 of the 1882 Act contained a saving provision for "debentures of ...companies." In keeping with the problems encountered with other provisions of the Act, the meaning of debentures and the types of company which could benefit from the s.17 exemption gave rise to a great deal of difficult caselaw. Although the definition adopted by the courts of "debenture"⁸³ was wide enough to include bills of sale mortgages, the cases which settled that company debentures were outside the Act were all cases involving floating charges.⁸⁴ It was not until 1891⁸⁵ that the Court of Appeal finally established the floating charge to be subject only to the Companies Act registration requirements and to be outside those of the Bills of Sale Acts. Doubt still remained as to whether a chattel mortgage executed by a company was subject to registration under the Bills of Sale Act.

The floating charge, which by this time had only been around for about twenty years,⁸⁶ in practical terms: (i) was much simpler to draft than a traditional bill of sale; (ii) was arguably more encompassing; (iii) had the added advantage of allowing for the appointment of a receiver and manager to realise the security, as a charge over the undertaking (the usual form of a floating charge) includes the right to carry on the business; (iv) was certain to be above any attack based upon

⁸¹ See question and answer detailed in House of Commons Select Committee on Bills of Sale - British Parliamentary Papers 1881 (34) VIII.1 at para.83 "Companies give bills of sale to their bankers? - Undoubtedly." See also Hansard HC Col 1415 March 20 1882 where an attempt was made to introduce a provision not dissimilar to s.245 Insolvency Act 1986: where a Company registered under "The Companies Act, 1862, is wound up either compulsorily or voluntarily within twelve months after execution by such company of a bill of sale, such bill of sale shall, as against the liquidator or liquidators of such Company, be void in respect of any personal chattels which at or after the date of the commencement of such winding up are in the possession, or apparent possession, or the order and disposition of such Company."

⁸² See e.g. *Shears v Jacob* (1866) LR 1 CP 513, *Deffell v White* (1866) LR 2 CP 144 and *Attenborough's Case* (1885) 28 ChD 682.

⁸³ See e.g. *Levy v Abercorris Slate and Slab Co.* (1887) 37 ChD 260.

⁸⁴ See e.g. *Read v Joannon* (1890) 25 QBD 300.

⁸⁵ *Re Standard Manufacturing* [1891] 1 Ch 627.

⁸⁶ Introduction of the floating charge taken to be *Re Panama, New Zealand and Australian Royal Mail Co* (1870) 5 Ch App 318.

invalidity under the Bills of Sale Acts; and (v) was not subject to public registration. This final point was highlighted in the House of Commons debate on the Preferential Payments in Bankruptcy Act 1897 (in the context the meaning of “debenture” is equated with “floating charge”) where it was stated that: “A debenture need not be registered under the Bills of Sale Act, but a mortgage - a more formal instrument - if it included personal chattels, must be registered...A mortgage was at present in a position which was inferior in that respect to a debenture...”⁸⁷

The Floating Charge

In 1895 the Davey Committee⁸⁸ reported that “[t]here is no subject of greater importance connected with the administration of companies...than the question of the restrictions and limitations to be placed on the powers of a company to mortgage its property.”⁸⁹ At the same time that the House of Lords was commenting judicially that the manner in which the floating charge operated was a “great scandal”⁹⁰ it was said in debate in the House of Commons that: “Debentures were constantly made the instruments of systematic fraud on the part of vendors, sometimes of very rotten concerns. A business was sold, a debenture was taken in payment - often at a very extortionate price - and in the end a secret hand was stretched out, to the prejudice of the shareholders, employees and creditors, and the same vendor could retake possession of the full property for which he had been paid.”⁹¹

Once it was certain that company debentures were outside the registration requirements of the Bills of Sale Acts there was a period up to 1900 when there was no obligation for companies publicly to register security instruments over their assets. There was merely a requirement for the company to keep its own register of charges but, as was recognised by the Davey Committee, “many

⁸⁷ Hansard HC Sir Albert Rollit Cols 80-81 10 February 1897.

⁸⁸ Report of the Departmental Committee Appointed by the Board of Trade to Inquire what Amendments are necessary in the Act relating to Joint Stock Companies Incorporated with Limited Liability (1895) C.7776.

⁸⁹ *Ibid.* at para. 43.

⁹⁰ *Salomon's Case* [1897] AC 22 at 53 *per* Lord Macnaghten.

⁹¹ Hansard HC Sir Albert Rollit Col 81 10th February 1897. Rollit's suggestion at Col 81 that preferential debts should have priority over both floating and fixed security would have saved a lot of trouble in that the difference between fixed and floating charges would not have become such a crucial point as it is today.

companies, even amongst the largest and best-managed, keep no register at all.”⁹²

On the recommendation of Davey⁹³ the Companies Act 1900 made four types of charges publicly registrable.⁹⁴ The Davey recommendation did not extend to compulsory registration of mortgages or charges on book debts. It will be recalled that at this time individuals and partnerships did not have to register general assignments of book debts and to require companies “to register any such mortgages as an individual trader is not required to register, would unfairly handicap them in competition with individuals and unincorporated firms carrying on a similar business”.⁹⁵

This rather large hole in the registration system was not patched up by Parliament until the Companies Act 1907⁹⁶ which gave effect to the recommendation of the Loreburn Committee⁹⁷ to make book debt charges registrable. The House of Lords’ decision in the *Yorkshire Woolcombers*⁹⁸ case had to a large extent already achieved this result by interpreting what was ostensibly a mortgage of book debts as a floating charge. The House of Lords’ decision is open to many fundamental criticisms⁹⁹ and may in the author’s view only be defended on the basis that the public interest demanded that such book debt securities should be publicly registered.

Although Companies House does not hold figures for the numbers of company charges registered each year there is a reference in the Loreburn Report¹⁰⁰ that in 1904 there were 4,400 company charges registered. The total number of

92 Report of the Departmental Committee Appointed by the Board of Trade to Inquire what Amendments are necessary in the Act relating to Joint Stock Companies Incorporated with Limited Liability (1895) C.7776 at para. 47.

93 *Ibid.* at para. 48.

94 Section 14.

95 Para. 48.

96 Section 10.

97 Report of the Company Law Amendment Committee (1906) Cd 3052 the “Loreburn Committee” Report at para. 37.

98 *Sub nom. Illingworth v Houldsworth* [1904] AC 355.

99 See Gregory and Walton “Book Debt Charges: Following Yorkshire Woolcombers - Are We Sheep Gone Astray?” [2000] *Insolvency Lawyer* 157.

100 Loreburn Report Appendix at p. 91 Memorandum by the Registrar of Joint Stock Companies.

companies registered in 1904 was 3,477 made up of 3,068 private companies with only 409 going to the public.¹⁰¹

It is worthy of some consideration that in 1904 there were more debentures registered than companies. This in itself proves nothing but does suggest the likely frequency of a *Salomon v Salomon*¹⁰² type situation, that is, mostly private companies being registered with many being subject to debentures. Bearing in mind the fall in bills of sale registrations at this time it is likely that as far fewer individuals and partnerships were borrowing by way of bill of sale, many were incorporating their businesses and those companies were securing their borrowings by issuing debentures.

Although there is no suggestion that Mr Salomon himself was in anyway fraudulent, the "calamitous"¹⁰³ decision in *Salomon* certainly opened the way for less scrupulous businessmen. In evidence to the Loreburn Committee in 1906 the Timber Trade Federation highlighted a common practice:¹⁰⁴

"It is within the knowledge of the Federation that cases have occurred in which traders foreseeing that markets are likely to go against them have converted their businesses into limited liability companies worked by themselves or their nominees, and have then taken debentures for the purchase price. By this means it may happen that they acquire the goods supplied by their creditors in order to replace their lost capital and so transfer the loss from themselves to their creditors. It is certain that such operations are practically impossible to an individual trader, as his power of giving security upon his future property and book debts is so restricted by law that he is practically debarred from raising money upon such security. A trader by converting his business into a limited company can sell to such company (which is practically himself) the goodwill of his business at an unduly inflated figure and then lend money represented by such goodwill to the company (i.e.) to himself on the security of debentures. A company conducted by fair minded and honest directors, however constituted,

101 Loreburn Report Appendix at p. 93 Further Memorandum by the Registrar of Joint Stock Companies. Companies registered in 1901 (the first year of 1900 Act which restricted the more questionable activities of promoters) totalled 3,132 with 2,485 being private and 647 going public. It is interesting to note the impact of the 1900 Act as in 1900 the last year before the 1900 Act came into force a total of 4,509 companies were registered - see 27th General Annual report by the Board of Trade 1st August 1918.

102 [1897] AC 22.

103 Kahn-Freund "Some Reflections on Company Law Reform" (1944) 8 MLR 54 at 54.

104 Memorandum by the Timber Trade Federation of the United Kingdom at p.81 of the Appendix to the Loreburn Report.

would not take advantage of any facilities which the Companies Acts may afford to defraud its creditors, and in such cases an amendment of the law would involve no hardship whatever to such companies, of which there are excellent examples in the wood trade.”

This type of activity was still being complained of in evidence to the Wrenbury Committee¹⁰⁵ in 1918.

Choice of security instruments may not have been the only reason to incorporate small businesses but along with limited liability *Salomon* promised the businessman his money back if the company failed, as long as he had taken a debenture for some or all of the price of the business transfer to the company. Evidence from the late nineteenth and early twentieth centuries certainly shows that the limited company took over a lot of business from previously unincorporated business and issued a lot of debentures. During the same period, sole traders and partnerships issued far fewer bills of sale.¹⁰⁶ Floating charges have never been subject to bankruptcy's order and disposition clause. It has already been demonstrated what that can do for the popularity of a security over after acquired property.

The Loreburn Committee commented in 1906 that: “If the practice of raising money by floating charges had recently commenced, or had been adopted only to a small extent, some of us would have been inclined to prohibit this mode of raising money by a security upon future assets.”¹⁰⁷

A minority report by some of the members of the Loreburn Committee explained the fraud perpetrated where a company carries on business with money borrowed from banks and guaranteed by the participators of the company who take a floating charge over the company's undertaking. The participators carry on business, are paid their salaries, receive interest on the loan even if no profit is made and at the end of the day when the company fails, seize the assets and get

¹⁰⁵ Report of the Company Law Amendment Committee Cd. 9138 paras. 63 and 64.

¹⁰⁶ Figures for companies and individuals do not include book debt securities as these were not registrable by companies until 1907 and by individuals until 1914 (and then only for general assignments of book debts).

¹⁰⁷ Loreburn Report at para. 41. The Appendix to the Report contains the evidence of many interested parties who were strongly in favour of abolition of floating charges and for companies to be put in the same position as traders under the Bills of Sale Acts e.g. Manchester, Edinburgh, Nottingham and Wakefield Chambers of Commerce.

their money back at the expense of the unsecured creditors.¹⁰⁸ Such “sharp practice”¹⁰⁹ was not, however, the main ground for objecting to floating charges.

A bigger concern was that a company has not the same sense of restraint an individual fearing bankruptcy has and “little or no personal discredit falls upon them if their company fails to pay a dividend to its trade creditors.”¹¹⁰ The floating charge it was argued encourages trading wholly or almost wholly with borrowed capital – “a very common practice in the establishment of small concerns.”¹¹¹ Loans carry interest even if no profit is made and consequently there is a greater risk of failure. Although by 1906 floating charges were registrable, because they were so universal they were no longer a “danger signal”¹¹² and to refuse credit to such companies would hamper any manufacturer or merchant’s trade greatly.

The minority report recommended putting companies on the same footing as individuals in preventing them from charging future chattels. The long term thinking behind this recommendation was that although it would reduce the amount that could be borrowed on such debentures “companies will obtain a larger general credit by reason of trade creditors no longer having the fear that the whole of the assets will be swept away by the debenture holders.”¹¹³

The minority report was ignored and the floating charge continued its rise as the most popular form of corporate loan security in the twentieth century. It has been subjected to criticism almost throughout its lifetime.¹¹⁴ The main threat to the floating charge in recent years has not been that it is likely to be outlawed but that it has become vulnerable to other claims in insolvency taking priority.

108 The minority cited as examples of this type of conduct *Re Crigglestone Coal Co.* [1906] 2 Ch 327 and *Re London Pressed Hinge* [1905] 1 Ch 576.

109 Loreburn Report at p.28.

110 *Ibid.*

111 *Ibid.*

112 *Ibid.*

113 *Ibid.*

114 See e.g. Report of the Review Committee on Insolvency Law and Practice (1982) Cmnd 8558, the “Cork Committee” Report at paras. 105, 437 and 1480.

Conclusions

There is a strong argument that floating charges and all other securities over future property remain as fraudulent against the unsecured creditor today as they did in 1882, 1906, 1918 and 1982. In 1895 it was stated that the power to mortgage future book debts and chattels and to execute floating charges was "the main reason why private partnerships are turned into joint stock companies."¹¹⁵ Is it sensible for the Law Commission to consider expansion of the floating charge empire when for nearly a hundred years the best thing that can be said about the floating charge is that it is too late now to abolish it? It could be argued that because everyone is so familiar with the popularity and the workings of the floating charge in the corporate field that everything should be left alone for companies. Would people dealing with registered partnerships have the same view or would they be caught out by a twenty-first century registered partnership version of *Salomon*?

If the Law Commission's suggestion that registered partnerships should be made exempt from the 1882 Bills of Sale Act became law, would such partnerships jump on the floating charge bandwagon? Companies did so largely because they wanted to avoid the problems of the 1882 Act and at least until 1900 they did not have to register publicly their charges. Companies up to that point enjoyed all the benefits that the pre-1854 moneylenders wallowed in when they took secret bills of sale, but without the pitfalls of, *inter alia*, the order and disposition clause in bankruptcy.

If a bank was allowed to lend money to a registered partnership free from the restrictions of the 1882 Act, it would be best advised to take an old style mortgage bill of sale listing all assets present and future, coupled with a "lightweight" floating charge¹¹⁶ to ensure it could still appoint an administrative receiver to enforce the security effectively. All of the old nineteenth century advantages that a floating charge had over the mortgage bill of sale would no longer be present. The bank would have all the benefits of an all encompassing fixed security and would maintain the advantage of the floating charge for enforcement.

¹¹⁵ Evidence of the Walsall Chamber of Commerce to the Davey Committee - Appendix at p.130.

¹¹⁶ See generally Odithah "Lightweight Floating Charges" [1991] JBL 49.

It has been suggested that most partnerships nowadays would not wish to take up the possibility of executing a floating charge.¹¹⁷ This may be so, at least partly because partnerships, without the “benefits” of limited liability and the floating charge, have generally conducted their business responsibly in the sobering knowledge that if they did not, the full weight of bankruptcy would land upon them. In an echo of the Loreburn minority report, it could be argued that partnerships enjoy a larger general credit because their creditors do not fear a debenture holder sweeping off all the firms’ assets should they become insolvent.

The question of whether or not existing partnerships take up the proposed extended power of lending ignores the general commercial need for a fixed security over changing assets. This need is apparent by the banks’ quest over the last 30 years for this particular holy grail. It may be, therefore, that existing partnerships decide not to execute this type of security, but that existing limited liability companies re-register as limited liability partnerships in order to take advantage of it. The partners would retain the benefits of limited liability but the banks could take a far more effective form of security over the partnership’s assets than they could ever do if the business remained a company.

It is interesting to note that the courts have somewhat astonishingly always closed their eyes to the obvious contradictions between the old bills of sale mortgage cases dealing with individuals and partnerships, where the dealing power was either express or implied, and the more recent corporate security cases. The present obsession with the idea that fixed security causes paralysis of the business is a product only of the company cases though its origins lie in an unfortunate aberration in the common law courts.¹¹⁸ The company cases, typified by *Yorkshire Woolcombers*, have at times struggled to maintain the illogical party line that where there is any security over changing assets with a power in the chargor to deal with the charged assets, the charge must float and cannot be fixed.¹¹⁹

Although the position for corporate security appears to be set in stone, it would be difficult for a court considering a partnership mortgage bill of sale when freed from the 1882 Act to do anything other than follow *Holroyd*. The absence of

117 “Alternative Company Structures for Small Businesses” Chartered Association of Certified Accountants, Research Report 42 by Andrew Hicks, Robert Drury and Jeff Smallcombe 1995.

118 See *Graham v Chapman* (1852) 12 CB 85. This matter has been explained in a forthcoming article in *Lloyd’s Maritime and Commercial Law Quarterly*.

119 Consider *Re Atlantic Computer Systems plc* [1992] Ch 505, *Re Atlantic Medical Ltd* [1993] BCLC 386 and *Re Cimex Tissues Ltd* [1994] BCC 626.

pre-existing supporting authority for the *Yorkshire Woolcombers* decision - a company case - would make it unlikely that it would be used to overhaul cases dealing with security issued by individuals or partnerships. This is especially so when it is realised that *Holroyd* itself was the product of several centuries' equitable wisdom. The decision in *Yorkshire Woolcombers* is at best full of legal problems and is not made the more convincing by the courts' modern day constant unquestioning acceptance of it. If the banks want specific security with dealing power, and they obviously do, then registered partnerships could be the answer to their dreams. The only remaining benefit to company participators would be limited liability¹²⁰ but this would disappear as limited liability would be available to the partners if they registered as a limited liability partnership.

Permitting partnerships to execute securities over future assets may well open a can of worms. The future under this proposed new regime holds the added excitement of the courts potentially having this rather ridiculous divide between partnerships, where secured lending has one set of rules as to what a specific security is and companies, where a completely different set of rules applies. The worm of secured lending would be chopped into two halves, each having its own lifestyle. If this does happen it would not be until after the Privy Council has decided *Brumark*. If the Privy Council adhere to the reasoning in *Yorkshire Woolcombers*, the decision in *Brumark* may in a few short years end up looking not unlike its fellow Privy Council decision of *Downsview Nominees Ltd v First City Corpn Ltd*¹²¹ - not overly convincing and by no means universally popular.

¹²⁰ Often this is merely an illusion as banks will frequently demand personal guarantees from the directors on top of any security.

¹²¹ [1993] AC 295. The consideration in *Downsview* of the duties owed by receivers has largely been superseded by the Court of Appeal's decision in *Medforth v Blake* [2000] Ch 86.

Fixed and floating charges—a revelation

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The accepted theory of the creation of the floating charge has no basis in law or fact. The sole reason for adopting the statutory “undertaking” mortgage (later the floating charge) was to evade an 1852 common law bankruptcy ruling that mortgages over changing assets paralysed business. This doctrine was expunged in 1883 as heresy, thereby destroying the basis of the “paralysis” dicta in early floating charge cases. Paradoxically, modern company lawyers are re-engaging in the defunct 19th century “paralysis” battle, whereas in truth the modern law is that mortgages with implied dealing power are in full force and effect today.

In *Siebe Gorman & Co. Ltd v. Barclays Bank Ltd*,¹ in 1979, Slade, J., said:

In my judgment, however, it is perfectly possible in law for a mortgagor, by way of continuing security for future advances, to grant to a mortgagee a charge on future book debts in a form which creates in equity a specific charge on the proceeds of such debts as soon as they are received and consequently prevents the mortgagor from disposing of an unencumbered title to the subject matter of such charge without the mortgagee’s consent, even before the mortgagee has taken steps to enforce its security.

In Slade, J.’s *dicta* on the book debt fixed charge, many banking lawyers saw the prospect of new and exciting forms of specific security cover for bank lending. Oddly, for those who had obtained not dissimilar results over the profits of Eastern Haddon Church in the reign of Henry VI² there was only that dull satisfaction which stems from following established practice.³ In this way the confident expectations of the sophisticated modern practitioner and the settled routine of the simpler ancients ran in harmony. The reason for excitement in 1979 was that Slade, J., tendered book debts as suitable material for specific

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The authors are most grateful for the very considerable assistance furnished by David Graham, Q.C., who before his retirement was the *doyen* of the bankruptcy Bar and whose knowledge of the history of his subject is vast. A debt of similar magnitude is owed to Dr Pamela Nightingale, whose work on medieval economics shows that there is surprisingly little that is new under the sun.

1. [1979] 2 Lloyd’s Rep. 142, 159.

2. Early Chancery Proceedings C1 7/154 in the Public Record Office system 8 Henry VI.

3. Memorandum of assignment of the revenues of the See of Winchester to the King’s Sureties for payment of money advanced by certain London merchants for payment of debts due to Peter of Savoy (C47 13/11 in the Public Record Office system 43 Henry III).

security notwithstanding that they are a form of property which constantly circulates in business. To any company lawyer they are quintessential floating charge property.⁴

Modern faith in the floating charge rests largely upon Professor Pennington's great article "The Genesis of the Floating Charge"⁵ ("the Genesis"), which argues that English common law rejected the Roman *hypotheca* altogether and equity remedied this defect only in 1862 in the "first leading case"⁶ of *Holroyd v. Marshall*.⁷ Professor Goode, in "The Exodus of the Floating Charge"⁸ ("the Exodus") follows the same sweep of history, noting that English courts could not reconcile a dealing power with an attached security interest. "Astonishingly",⁹ he says, the Romans developed *hypotheca*, which took root here, as the floating charge, 800 years after the decay of Roman dominance.

Given that commercial law developments are a response to commercial needs,¹⁰ it follows that both Roman and late Victorian commerce were convinced of the utility of a security over present and future assets which left the grantor, without let or hindrance, to deal with them in the course of business. This all sounds very respectable. But, one wonders, was trade so diminished in the intervening centuries that security having these features was unnecessary? Was it available? The answers, respectively, are—No and Yes.

If "No and Yes" (as expanded hereafter) constituted the whole story, the *hypotheca* would be little more than a picturesque antiquity drafted into English law to delight the intellect. It was anything but that. Contrary to popular belief, however, its initial creation was not for the purpose of giving substance to what had hitherto always been a void in the law, rather it was a slightly desperate attempt to recover from the common law's paralysing attack in 1852, in *Graham v. Chapman*,¹¹ upon equity's future property mortgage with dealing power. As we shall see, the attack was aberrational and short-lived. But the timing of it and its vigour were such that twinges of paralysis afflict the *corpus iuris* even today. It was a later event—the Bills of Sale legislation of 1882—that thrust the *hypotheca* into a permanent place in English law. The dominant position which it rapidly achieved was the result of simple commercial pragmatism at the time rather than considerations of doctrinal accuracy. Unfortunately one or two impurities remain in the system.

The authors' preferred culprit for the misunderstandings as to the origin and nature of security over company personalty, and in particular the floating charge, is the failure to give due weight to the role of the bankruptcy law. In fact, the state of the bankruptcy law

4. The Chancery Division has ever since *Siebe Gorman* required: (a) chargee possession or control of the security while the charge lives—e.g., *Royal Trust Bank v. National Westminster Bank Plc* [1996] B.C.L.C. 682; *Re Cosslett (Contractors) Ltd* [1997] B.C.C. 724; *Re Brightlife Ltd* [1987] Ch. 200; *Re Westmaze Ltd* [1999] B.C.C. 441 and *Re Double S Printers Ltd* [1999] B.C.C. 303—and (b) further chargor/chargee conveyancing whenever property of the security description is acquired or alienated by the chargor—e.g., *Re Croftbell* [1990] B.C.L.C. 840, 847, *per* Vinelott, J., and *Re Keenan Bros Ltd* (1986) 2 B.C.C. 98,970, 98,974–975, *per* McCarthy, J., citing and approving the court below. This was an "extreme commercial improbability" (*Re Brightlife* [1987] Ch. 200, 209, *per* Hoffmann, J.). Acquisitions would require new deeds of substitution.

5. (1960) 23 M.L.R. 630.

6. *Ibid.*, 634.

7. (1862) 10 H.L.C. 191; 11 E.R. 999.

8. D. Feldman and F. Meisel (eds), *Corporate and Commercial Law: Modern Developments* (London, 1996) 193, 195–198, 203.

9. *Ibid.*, 195.

10. *Ibid.*, 193.

11. (1852) 12 C.B. 85; 138 E.R. 833.

in the latter half of the 19th century was decisive: for example, the Judicature Act 1875 applied bankruptcy law as to “the respective rights of secured and unsecured creditors”¹² wholesale to insolvent winding up.

The authors’ aim here is to demonstrate that, unless the courts are prepared to hold (a) that there is no difference between a mortgage and a charge and (b) that companies are unable to grant mortgages over their present and future personal property, then that which has been English law since the Middle Ages, with a short interruption in the period 1852–1883, is good law in 2001.

I. THE PERSONALTY MORTGAGE

A. Early beginnings

From the latter part of the 14th century and into the 15th a very large amount of trade was conducted on credit so that security became a significant issue.¹³ Postan,¹⁴ who did signal work on medieval trade, described credit requirements and the state of financial instruments in this period. He notes, particularly, the use of conditional bills of sale and the increasing use of assignments of debt to finance trade.¹⁵ Dr Pamela Nightingale, the distinguished economic historian, has expounded the vicissitudes of the money supply in this period and the concomitant requirement for credit both to cope with shortages and to finance expansion.¹⁶ She, too, testifies to the value of gifts of goods and chattels (i.e., mortgages) at this time and analyses such a gift executed by one John Hall in 1396 by reference to principles in Sir Frederick Pollock’s “Gifts of Chattels Without Delivery”¹⁷ and Sir William Holdsworth’s *History*.¹⁸

In his learned introduction to the *Calendar of Select Pleas and Memoranda of the City of London 1437–1457*,¹⁹ Philip E. Jones states that the practice of mortgaging personality spread from London and, just as landowners mortgaged their estates, so the citizens of London used to pledge their goods, comprising stock in trade, household chattels and implements of their craft, without parting with actual possession. He highlights the fact that many of these “gifts of goods and chattels” and the debts behind them were only acknowledged in the courts years after execution, probably for the purposes of enforcement when the donor was “unable to meet the debt as a security for which the deed was made”.²⁰ Along with those in the Close Rolls, 2,000 of them were acknowledged in court alone in the period 1437–1457. Dr A. H. Thomas’s introduction to the 1413–1437

12. Judicature Act 1875, s. 10.

13. There is a large body of literature on the subject of post-1300 credit. See, e.g., the sources cited by P. Nightingale, “Monetary Contraction and Mercantile Credit in Later Medieval England” (1990) *Economic History Review* 560.

14. M. M. Postan, *Medieval Trade and Finance* (Cambridge, 1973).

15. *Ibid.*, 30–33, 40–42.

16. “Monetary Contraction and Mercantile Credit in Later Medieval England” (1990) *Economic History Review* 560.

17. (1890) 6 L.Q.R. 446.

18. Holdsworth, *A History of English Law*, Vol. III, 5th edn (London, 1942), 336–338, 346–349.

19. “Introduction: Gifts of Goods and Chattels”, *Calendar of Select Pleas and Memoranda of the City of London 1437–1457* (Cambridge, 1954), esp. XXII–XXV.

20. *Ibid.*, XXIII.

Calendar,²¹ refers to the "ever larger space"²² in the London rolls and in Chancery records taken up by these debts and deeds. He cites a transaction of 10 September 1392,²³ in which a recognizance of debt was entered, followed one month later by a deed giving all goods and chattels to the creditor, and a marginal note in the Roll recorded that three years later "satisfaction" was acknowledged and the "obligations" were cancelled. Thomas notes that there were other instances where "all goods and chattels" passed under the deed and trade nevertheless continued.²⁴ A slightly later example²⁵ is a transfer on 6 September 1455 by Richard Bonde (a tailor) of all his "vessels utensils and brewing hustlements of leade and wood" in the "Brewhouse le Thre nonnes super le Hoope" in Sketebourne Lane, St Mary Woolnoth along with the public house and, as the *Calendar* says, "all his other goods and chattels and debts owing to him". The deed was enrolled on 30 March 1457.

Four points emerge at this early stage—there were thousands of transactions; it was possible to mortgage chattels by class description as well as by individual identification; in very many cases there was only a token delivery to the mortgagee of one (trifling) item out of the chattels mortgaged, which left the balance of secured assets in the actual possession of the mortgagor; and, lastly, the mortgagor carried on trade using and turning over the security.

The commercial practices established in the Middle Ages carried on. These mortgages (usually in the form of a sale subject to defeasance upon repayment) were reduced to standard terms in, for example, Phayer's *Newe Boke of Presidentes*²⁶ (1543), William West's two part *Symbolæographie*²⁷ (1590 and 1594, revised several times), Sheppard's *President*²⁸ (1603) and *The Young Law Clerk's Tutor*²⁹ (1682). Thus far the progress of the personalty mortgage looks like one of continuous plain sailing. Continuity was never in doubt so long as business needed to borrow (and it did). The sailing, however, was not always plain.

B. The battle between the common law and equity: statutory intervention

By a private transaction the lender had security, the borrower the advance and the borrower's credit was unimpaired because no-one else knew about it. In the event of financial collapse, however, trade creditors received nothing from the borrower's bankruptcy because the assets were all swept up in the conditional bill of sale, a secret

21. "Introduction: Gifts of Goods and Chattels", *Calendar of Select Pleas and Memoranda of the City of London 1413-1437* (Cambridge, 1943), esp. XIX-XXIII.

22. *Ibid.*, XX.

23. *Ibid.*, XXII.

24. *Ibid.*, XXIII.

25. Plea and Memoranda Rolls, Roll A81 membr.2v.

26. T. Phayer, *A newe boke of Presidentes in Muner of a Register, wherin is comprehended the very trade of making all maner euydence and instruments of Practyse, etc.* (London, 1543).

27. W. West, *Symbolæographie; which may be termed the Art, Description, or Image of Instruments, Couenants, Contracts, etc.* (London, 1590).

28. W. Sheppard, *The President of Presidents: or One General President for Common Assurances by Deeds* (London, 1603).

29. Edward Cocker, *The Young Clerk's Tutor. . . To which is annexed, several of the best copies both court and chancery-hand now extant* (London, 1682).

document. Thus a large and visible stock, which created the appearance of ownership, wealth and creditworthiness, was, or could be, a delusion.

The common law had (by the 16th century) long harboured an antipathy to secret transfers of chattels and delusive credit. Secret transfer of chattels was anathema in Anglo-Saxon society. Addison on *Contracts*³⁰ refers to the Laws of Athelstan and other Anglo-Saxon kings proscribing transfers of chattels in the absence of publicity such as sales at market or in the presence of credible witnesses. The common lawyers had had one instance struck down by statute in 1379.³¹ By the Statute of Elizabeth 1570³² they struck again and invalidated transfers of real or personal property for the "... Purpose and Intent, to delay, hinder or defraud Creditors and others of their just and lawful Actions, Suits, Debts ...".³³ The personalty mortgage with grantor possession and trade dealing had grown largely by the efforts of the Customary Law Merchant and Chancery, which saw it as a vital institution to promote trade. The Statute of Elizabeth was merely declaratory of the common law³⁴ but Chancery could not override a statute as easily as it overrode the common law.

The high water mark of the common law was *Twyne's Case*,³⁵ where Pierce assigned his goods to Twyne but remained in possession at a time when he owed more than their value to Twyne plus a debt to a third party whose action was pending. The Star Chamber's fifth resolution was "[h]ere was a trust between the parties, for the donor possessed all, and used them as his proper goods, and fraud is always apparelled and clad with a trust, and a trust is the cover of fraud".³⁶ In his report Coke, with evident satisfaction, advised his readers to make their deeds public, have "good people"³⁷ appraise the value of the goods, assign expressly in satisfaction of the debt and, lastly, take possession because grantor possession is a trust "*per nomen speciosum*"³⁸ and such a trust "is in truth, as to all the creditors, a fraud, for they are thereby defeated and defrauded of their true and due debts".³⁹ Coke's rally still stirred common lawyers in the 19th century.⁴⁰

Coke's suggestion, that secrecy plus grantor possession and dealing was *per se* fraud, would have been fatal to the personalty mortgage. Two points, however, should be noted: (a) *Twyne's Case* involved an absolute assignment rather than a mortgage; and (b) in the case of mortgages it was not usual for the mortgagee to take possession if for no other reason to avoid the mortgagee in possession's liability to account for wilful default. In the case of mortgages, since transfers "upon good Consideration and *bona fide* lawfully conveyed or assured to any Person"⁴¹ without notice were excepted by the Statute of Elizabeth, where grantor possession was consistent with the deed, it was held no fraud. Thus, in *Bucknal v. Roiston*⁴² a supercargo embarking on a trading voyage mortgaged the

30. 3rd edn (London, 1853), 249–250.

31. Statute For Relief of Creditors against Fraudulent Deeds made by Debtors 2 Ric. II c.3.

32. 13 Eliz I c. 5.

33. *Ibid.*, the preamble.

34. See *Ryall v. Rolle* (1749) 1 Atk. 165, 178; 26 E.R. 107, 115.

35. (1601) 3 Co. Rep. 80b; 76 E.R. 809.

36. (1601) 3 Co. Rep. 80b, 81b.

37. *Ibid.*, 81a.

38. *Ibid.*, 81b.

39. *Ibid.*

40. See, e.g., *Graham v. Chapman* (1852) 12 C.B. 85.

41. 13 Eliz I c. 5, s. 6.

42. (1709) Prec. in Ch. 285; 24 E.R. 136.

outgoing goods and the "produce and advantage that should be made thereof".⁴³ The court held that the supercargo's possession was consistent with the mortgage (here expressed in the old language of a letter of trust) and there was no fraud. The mortgagee prevailed over an execution creditor with respect to the end products of the voyage.

In 1788 Buller, J., complained about *Bucknal* but accepted it as correct.⁴⁴ Nearly a century later in *Ex p. Games*⁴⁵ a farmer mortgaged his stock and debts and any subsequent items of that description. He then ran the business for four years before default provoked seizure. James, L.J., refused to find fraud: "The mortgagor was intended to remain in possession of the property and to carry on his business, substituting new chattels for those which he sold in the course of his business, and the security of the mortgagee was to remain upon the substituted chattels. He got the substituted chattels in place of those which he allowed to be withdrawn by the mortgagor."⁴⁶

Returning to our narrative, even within 20 years of *Twyne's Case* it was apparent to the common lawyers that the Statute of Elizabeth was inadequate to suppress delusive credit. After two abortive attempts in 1614 and 1621, the Bankruptcy Act 1623⁴⁷ was passed which introduced the order and disposition clause.⁴⁸ Coke had a hand in its Parliamentary passage. One member remarked in the debate that: "This possession of the bankrupt the grant being concealed was the motive of the Bankrupt's great trust and credit. This possession of the Bankrupt is a badge of fraud, and lyeth in the desck many yeeres thus concealed."⁴⁹ It was enacted that, where at the time of becoming bankrupt any persons "shall by the Consent and Permission of the true Owner and Proprietary have in their Possession, Order, and Disposition, any Goods or Chattels whereof they shall be reputed Owners, and take upon them the Sale, Alteration or Disposition as Owners . . .",⁵⁰ the goods and chattels fell into the bankruptcy estate.

The progress of the personalty mortgage under the order and disposition clause is slightly unexpected. In 1740 Lord Hardwicke⁵¹ noted that, apart from a case before Lord Talbot in 1736,⁵² there had been no decisions on these conditional sales (mortgages) under the clause. Stressing the inconvenience to trade should the clause apply but acknowledging the delusive credit problem, he denied its applicability to conditional sales. Lord Hardwicke also said that, if it really had been considered possible that mortgages were within the 1623 Act, the point would not have taken more than 100 years to come before the court. His Lordship adhered to this approach in *Brown v. Heathcote*.⁵³

In *Ryall v. Rolle*,⁵⁴ however, Lord Hardwicke recanted his previous views. Harvest, a brewer, had entered into seven mortgage transactions (and one absolute sale to an incoming partner) between 1725 and 1738 and became bankrupt in 1740. The mortgages

43. *Ibid.*

44. *Edwards v. Harben* (1788) 2 T.R. 587; 100 E.R. 315.

45. (1879) 12 Ch.D. 314.

46. *Ibid.*, 323. See also *Martindale v. Booth* (1832) 3 B. & Ad. 498; 110 E.R. 180; *Alton v. Harrison* (1869) 4 Ch. App. 622; and *Allen v. Bonnett* (1870) 5 Ch. App. 577.

47. 21 Jac. 1 c. 19.

48. *Ibid.*, s. 11.

49. Notes in Parliamentary Debates, Vol. VII, Appendix A, at 107.

50. 21 Jac. 1 c. 19, s. 11.

51. *Bourne v. Dodson* (1740) 1 Atk. 154, 157; 26 E.R. 100, 101.

52. *Stephens v. Sole* (1736) 1 Ves. 352; 27 E.R. 1077.

53. (1746) 1 Atk. 160; 26 E.R. 103.

54. (1749) 1 Atk. 165.

involved brewing utensils and stock in trade and in three instances his house, brewhouse and out-houses. The assignees in bankruptcy claimed, *inter alia*, the personal property as being in Harvest's possession, order and disposition in his trade at the time of becoming bankrupt. Lord Hardwicke called in Lee, L.C.J., Parker, L.C.B., and Burnet, J. (respectively King's Bench, Exchequer and Common Pleas). His earlier attempts to protect mortgages from the order and disposition clause on the basis that the mortgagee (conditional vendee) was not the true owner were abandoned. It was held both at law and under the order and disposition section that the mortgagee was the owner. Lord Hardwicke explained the policy of the order and disposition clause as follows:⁵⁵

The general view of the provision now under consideration, was to prevent traders from gaining a delusive credit from a false appearance of their circumstances, to the misleading and deceit of those who should trade with them, and the legislature thought they had done this by subjecting all things remaining in the possession of the bankrupt, to the creditors under the commission, because where the vendee leaves the goods bought in the possession of the bankrupt, he confides as much in the general credit of the bankrupt, as that creditor who has taken only a bond or note. In such cases, the bankrupt had it in his power to sell all the goods the next hour, and the vendee or assignee could not claim them from the buyer, but could only have a personal remedy against the bankrupt. All this holds as well in the case of conditional, as of absolute sales.

From the standpoint of the main thesis being developed, that mortgages with dealing power were commonplace, it must be added that Lord Hardwicke's view of the power of the mortgagor to deal with the security was supported, not opposed, by the common law judges. Burnet, J., put *choses in action* within the clause "... as the specifick goods, by being left in the bankrupt's possession, would be subject to the commission, so must the profits be in choses in action, arising from these goods ...".⁵⁶ Parker, L.C.B., stated: "It is allowed to be out of the question, that the stock mortgaged underwent changes, for there is no doubt, but the produce is subject to the mortgage of the stock itself."⁵⁷

The common law was not opposed to the concept of a mortgage with a power to deal. Its dislike was reserved merely for certain consequences. Such mortgages would be struck down if entered into fraudulently (entrenched by the Statute of Elizabeth). They were perfectly effective, however, as regards property existing at the creation of the mortgage. As regards future property the legal title would depend on a *novus actus* such as possession or a new deed. Prior to a *novus actus* the mortgagee (conditional vendee) had only a contract, not a property in the goods. It was nevertheless a good covenant. Furthermore, *Ryall v. Rolle*⁵⁸ is authority that, where future property fell within the terms of the order and disposition clause as mortgaged property, the courts would strike it down on that ground, rather than upon some notion of intrinsic invalidity.

The practical consequence of the order and disposition clause was to make mortgagees watch their trade mortgagors' progress more carefully. Grantor possession and consent to it by the mortgagee only defeated the mortgagee if it occurred at the time when the mortgagor became bankrupt. So long as mortgagees obtained possession or took available steps before bankruptcy, the clause had nothing to bite on.⁵⁹ If, however, they failed to do

55. *Ibid.*, 183.

56. *Ibid.*, 172.

57. *Ibid.*, 174.

58. (1749) 1 Atk. 165.

59. See, e.g., *Re Wright* (1876) 3 Ch.D. 70 and *Rutter v. Everett* [1895] 2 Ch. 872.

so, their priority was lost. For example, in *Longman v. Tripp*⁶⁰ a printer mortgaged his interest in a newspaper and the profits, carried on business for six months and became bankrupt. The mortgaged property including intangible interests fell to the bankruptcy assignees. Similarly, in *Re Neal*,⁶¹ where an artistic interior decorator mortgaged his present and future property including intangibles such as goodwill and debts and carried on for four years up to bankruptcy, the mortgagee lost to the trustee in bankruptcy.

C. The *Graham v. Chapman* saga

In this running battle, the common lawyers fired their most serious shot, ironically, just before compulsory registration of bills of sale⁶² ended the delusive credit aspect of their dispute with equity. The bullet was derived from an old design. While the bankruptcy law was from its inception in 1542 a statutory process, the judges had developed rules which they engrafted on to it (the "policy of the bankruptcy laws"). Contraventions were described as a "fraud on the bankrupt laws" or an attempt to "defeat" them. Its rationale was that insolvents' proper estates should be distributed rateably to creditors.

Thus, in *Worseley v. Demattos*⁶³ a miller mortgaged all his present and future property including "all his changeable stock"⁶⁴ including debts for five shillings. "By the express tenor of the deed"⁶⁵ the grantor had absolute power to act as owner and dispose of mortgaged property. Lord Mansfield held the mortgage a fraud on the bankrupt laws and as such an act of bankruptcy. The banker had made no advances. Evidence that he intended to lend did not save the deed from being an act of bankruptcy (honesty is not the test here, unlike under the Statute of Elizabeth). In *Whitwell v. Thompson*⁶⁶ Lord Kenyon said that mortgages to secure fresh advances were outside the common law policy of the bankruptcy laws altogether.

In *Graham v. Chapman*,⁶⁷ however, Jervis, C.J., in the Exchequer, purportedly drawing on earlier authorities, expounded a revolutionary extension of them which had devastating effects. Larke, a Norwich draper being indebted to Chapman, borrowed further from him on a mortgage securing both loans. The mortgage covered all present and future property including stock and debts. Larke carried on trade for six months, defaulted (was dispossessed) and went bankrupt. In an issue between the bankruptcy estate and Chapman, the mortgage was held a fraud on the bankruptcy laws and liable to be defeated as an act of bankruptcy. After a full argument, Jervis, C.J., expressed the decision: "... the goods remaining in the trader's keeping gave him a false credit, whereas, in truth, he had legally no power to continue his trade, or to dispose of a single article of his stock, if the deed was good";⁶⁸ and "... the deed here is not for future advances, but for a present payment and a by-gone debt: it conveys all the trader's property, including the advance, and any

60. (1805) 2 Bos. & Pul.(N.R.) 67; 127 E.R. 547.

61. [1914] 2 K.B. 910.

62. Under the Bills of Sale Act 1854.

63. (1758) 1 Burr. 467; 97 E.R. 407. See also *Hassells v. Simpson* (1785) 1 Doug. 89; 99 E.R. 60 and *Devon v. Watts* (1779) 1 Doug. 86; 99 E.R. 59.

64. (1758) 1 Burr. 467, 468.

65. *Ibid.*, per Lord Mansfield.

66. (1793) 1 Esp. N.P.C. 68, 72; 170 E.R. 282, 284.

67. (1852) 12 C.B. 85.

68. *Ibid.*, 102.

property purchased with the advance: it necessarily defeats and delays creditors and is, therefore, an act of bankruptcy".⁶⁹ Jervis, C.J., referred to Lord Kenyon's view in *Whitwell*,⁷⁰ that "... it never can be taken to be law, that a trader cannot sell his property when his affairs become embarrassed, or assign them to a person who will assist him in his difficulties, as a security for any advances such person may make to him" and gave it short shrift—Lord Kenyon could not have intended his remarks to apply to facts not before him.

Bankruptcy estates thus had a new weapon with which to attack mortgages of all present and future property:

- (i) everything including the loan went immediately to the mortgagee;
- (ii) the mortgagor's express or implied power to deal was jettisoned; and
- (iii) the deed itself stopped the business and it was invalid *per se* as an act of bankruptcy.

The consequence was that the very transaction by which the trader sought to escape from financial difficulty (borrowing on present and future property mortgage) was itself the fatal blow to the business. In metaphorical terms it was somewhat worse than merely shooting oneself in the foot. Not surprisingly, bankruptcy estates founded arguments on *Graham* frequently⁷¹ because mortgage borrowing was a commercial mainstay of trade financing. The rejection of the power to deal, primarily a matter of construction of documents, was particularly crucial and was irreconcilable with the large body of cases which had implied it where it was not expressed.⁷² Lord Eldon would have found it incomprehensible. In *Nutbrown v. Thornton*⁷³ in an action by the mortgagor farmer his Lordship had expressly ordered the mortgagee to return the seized goods to the mortgagor on an implied term that the mortgagor should continue business (which included cattle dealing) either for seven years or until the debt exceeded £500, deciding that the mortgagor was under no obligation to keep the mortgaged property *in specie*.

69. *Ibid.*, 106.

70. (1793) 1 Esp. N.P.C. 68, 72.

71. See, e.g., *Hutton v. Crutwell* (1852) 22 L.J.Q.B. 78; *Young v. Waud* (1852) 22 L.J.Ex. 27; *Smith v. Cannan* (1853) 2 El. & Bl. 35; 118 E.R. 682; *Leake v. Young* (1856) 5 El. & Bl. 955; 119 E.R. 736; *Bittlestone v. Cooke* (1856) 6 El. & Bl. 296; 119 E.R. 875; *Pennell v. Dawson* (1856) 18 C.B. 355; 139 E.R. 1407; *Hale v. Allnutt* (1856) 18 C.B. 505; 139 E.R. 1467; *Lee v. Hart* (1856) 11 Ex. 880; 156 E.R. 1089; *Bell v. Simpson* (1857) 2 H. & N. 410; 157 E.R. 169; *Harris v. Rickett* (1859) 28 L.J.Ex. 197; *Jones v. M'Kenzie* (1859) 13 Moore 1; 15 E.R. 1; *Ex p. Cottrell* (1860) 35 L.T. 465; *Pennell v. Reynolds* (1861) 11 C.B. (N.S.) 709; 142 E.R. 974; *Lacon v. Liffen* (1862) 4 Giff. 75; 66 E.R. 626; *Smith v. Timms* (1863) 1 H. & C. 849; 158 E.R. 1127; *Topping v. Keysell* (1864) 16 C.B. (N.S.) 258; 143 E.R. 1127; *Young v. Fletcher* (1865) 34 L.J.Ex. 154; *Mercer v. Peterson* (1867) L.R. 2 Ex. 304; (1868) L.R. 3 Ex. 104; *Allen v. Bonnett* (1870) 5 Ch. App. 577; *Lomax v. Buxton* (1871) 6 C.P. 107; *Kevan v. Mawson* (1871) 24 L.T. 395; *Ex p. Bolland* (1872) 41 L.J.Bky. 60; *Ex p. Fisher* (1872) 7 Ch. App. 636; *Ex p. Greener* (1877) 46 L.J.Bky. 76; *Ex p. Games* (1879) 12 Ch.D. 314; *Re Rees* [1894] A.C. 135.

72. The following cases involved mortgages of stock or other personalty which were attacked as acts of bankruptcy, where possession remained in the mortgagor and where the parties either expressly or by necessary implication agreed that the mortgagor should continue to deal with the assets in the course of business: *Carr v. Burdiss* (1834) 1 C.M.&R. 443; 149 E.R. 1153; *Lindon v. Sharp* (1843) 6 Man. & G. 895; 134 E.R. 1154; *Hutton v. Crutwell* (1852) 22 L.J.Q.B. 78; *Ex p. Sparrow* (1852) 2 De G.M. & G. 907; 42 E.R. 1127; *Young v. Waud* (1852) 22 L.J.Ex. 27; *Stranger v. Wilkins* (1855) 19 Beav. 626; 52 E.R. 493; *Harris v. Rickett* (1859) 28 L.J.Ex. 197; *Ex p. Cottrell* (1860) 1 L.T. (N.S.) 465; *Young v. Fletcher* (1865) 34 L.J.Ex. 154; *Ex p. Foxley* (1868) 3 Ch. App. 515; *Ex p. Winder* (1875) 1 Ch.D. 290; *Ex p. Burton* (1879) 13 Ch.D. 102; *Ex p. Dann* (1881) 17 Ch.D. 26; *Ex p. Johnson* (1884) 26 Ch.D. 338.

73. (1804) 10 Ves. Jun. 159; 32 E.R. 805.

Graham was resounding but later judges did not consider it very sensible.⁷⁴ Commenting upon it, Bramwell, B., stated "[t]hat case has never been convicted, but has been in trouble a good many times".⁷⁵

While accepting it as law the courts sought (earnestly) to avoid it when possible. At least three stratagems were employed:

(a) The first was to ask whether the advance was made bona fide to enable the mortgagor to carry on in business, albeit this is the very question which the decision in *Graham* forbids to be put. Willes, J., in *Pennell v. Reynolds*,⁷⁶ stated: "The advance may be the means of enabling the assignor to go on with his trade, and so the transaction may be beneficial for the creditors."

In *Re Colemere*⁷⁷ Lord Cranworth, L.C., said: "But if it is for the purpose of enabling him to raise money to go on with his trade, that cannot be called a fraudulent act as tending to defeat and delay his creditors, for it probably is or may be the wisest step he could take to promote the interests of his creditors." In *Ex p. King*⁷⁸ James, L.J., concluded "... that the advances were substantial, and were bona fide made for the purpose of enabling the debtor to carry on his trade". In *Bittlestone v. Cooke*⁷⁹ Erle, J., said: "There often may be a very good reason for taking a security over the whole of a trader's stock present and future, as then the stock may be used in the meantime and made a source of profit, whilst, if a portion of the existing stock is separated and set aside as a security, it is tied up from use."

(b) In *Lomax v. Buxton*⁸⁰ Willes, J., attempted to distinguish and contain *Graham*:

I think that in dealing with the case of *Graham v. Chapman* we must take it to have turned on the particular terms of the deed, and the mode in which the advance was there made, and that though there was an advance in point of form, it came into the hands of the debtor under such circumstances that he did not get the real enjoyment of the money so advanced.

(c) The courts further differed from *Graham* in their construction of the mortgage deed, holding that trade stopped, not by virtue of the creation of the mortgage, but only when the mortgagee later enforced his rights under it.⁸¹

One judge who refused to have anything to do with *Graham* was Lindley, J. In *Walker v. Clay*⁸² he held:

The object of the bill of sale is obviously not to paralyse the trade of the grantor, but to enable him to carry on his trade, and the bill would be worthless if we were to construe it otherwise... I think, therefore, that the covenant not to remove is a covenant that the grantor will not remove or dispose of the goods otherwise than [than] in the ordinary course of his trade.

74. See, e.g., *Lomax v. Buxton* (1871) 6 C.P. 107; *Kevan v. Mawson* (1871) 24 L.T. 395 and *Ex p. Bolland* (1872) 41 L.J.Bky. 60. In *Kevan*, at 397, Bramwell, B., who had been counsel in *Graham*, observed: "I distinctly remember that Jervis C.J. had a strong opinion against me at the trial, and this may have slightly influenced his judgment."

75. *Kevan v. Mawson* (1871) 24 L.T. 395, 397.

76. (1861) 11 C.B. (N.S.) 709, 722.

77. (1865) 1 Ch. App. 128, 132.

78. (1876) 2 Ch.D. 256, 263.

79. (1856) 6 El. & Bl. 296, 310.

80. (1871) 6 C.P. 107, 113.

81. See, e.g., *Young v. Waud* (1852) 22 L.J.Ex. 27; *Stranger v. Wilkins* (1855) 19 Beav. 626; *Young v. Fletcher* (1865) 34 L.J.Ex. 154 and *Ex p. Foxley* (1868) 3 Ch. App. 515.

82. (1880) 49 L.J.Q.B. 560, 561.

Then, having been elevated to the Court of Appeal, he overruled *Graham* in *Ex p. Hauxwell*:⁸³

[*Graham*], it is said, shews that if a bill of sale is so worded as to enable the grantee to seize, not merely all the property of the grantor, but all his property including that which may be bought by him by means of the advance then made of him, it is necessarily an act of bankruptcy. Well, if *Graham v. Chapman* did decide that, it appears to me that it is distinctly wrong. It has been so considered ever since it was decided.

With these words the unloved doctrine of *Graham v. Chapman* was unceremoniously despatched. The importance of the case lies in the fact that in 1852 the vast bulk of private trade was conducted by individuals and partnerships and that when, a few years later, incorporated trade started to increase there was nothing inherent in the new company law system which would exempt companies from the *Graham v. Chapman* principle. Apart from matters such as *ultra vires*, due execution according to the articles of association, the *Turquand*⁸⁴ rule and registration, there is very little company law which is relevant to mortgages. Jervis, C.J.'s bolt from the blue threatened those financing the new companies and hence the supply of capital.

D. Bills of sale legislation

After *Hauxwell* the courts had no difficulty in cases upon pre-1882 bills of sale in upholding the mortgage with grantor possession and dealing. The problem was the Bills of Sale Act (1878) Amendment Act 1882, which outlawed bills of sale not in statutory form and prescribed a form which did not allow for future property. The Act did, however, grant some exceptions, the largest of which did permit future property where this was necessary for the "maintenance . . . of the security".⁸⁵ In *Coates v. Moore*⁸⁶ the mortgage duly scheduled the chattels and covered "all chattels and things which may at any time during the continuance of the security be substituted for them or any of them".⁸⁷ The mortgagor possessed for what appears to be a number of years after executing the mortgage, before suffering execution over his assets. The Court of Appeal decided that the mortgagee took priority over the execution creditor.⁸⁸

The Bills of Sale Act 1854 had introduced compulsory registration of bills of sale (renewable every five years), which spawned its own difficulties. In *Karet v. Kosher Meat Supply Assn*⁸⁹ the mortgage covered stock in trade. The mortgagee failed to re-register his security after five years and so lost his priority. The mortgagor traded on during this period and in the authors' view the chances that stock was left untouched for over five years are slender. In *Re Phillips*⁹⁰ an unregistered mortgage of growing crops lost priority because the statutory exemption for growing crops did not apply once the crops were cut. Jessel, M.R., said of the mortgage: "Is not the real meaning of this deed this—that the farmer

83. (1883) 23 Ch.D. 626, 638.

84. *Royal British Bank v. Turquand* (1856) 6 E. & B. 327; 119 E.R. 886.

85. Schedule to the Bills of Sale Act (1878) Amendment Act 1882.

86. [1903] 2 K.B. 140.

87. *Ibid.*, 142.

88. See also *Seed v. Bradley* [1894] 1 Q.B. 319.

89. (1877) 2 Q.B.D. 361.

90. (1880) 16 Ch.D. 104.

shall carry on his business in the ordinary way?"⁹¹ The court did not consider it worth discussing a covenant against removal without mortgagee consent.

E. Legal and equitable mortgages

As we have seen, the dispute between courts of law and of equity over present and future property mortgages was longstanding. Each held certain tenets which it was not willing to abandon. Delusive credit was a sticking point for common lawyers and their Parliamentary presence produced the Statute of Elizabeth and later the order and disposition clause. They nearly won the battle as a result of Jervis, C.J.'s judgment in *Graham*, which at a stroke destroyed the dealing power and branded the deeds as intrinsically fraudulent (in the bankruptcy sense) as contrary to the policy of the bankruptcy laws. The bankruptcy courts were in something of a frisson over it for 30 years.

The other main ground of dispute was the effect to be given to the future property provisions in bills of sale. The first point to note is that until *Graham* in 1852 both common law and equity accepted that they were perfectly capable of becoming effective. Divergence related to conditions of existence. Reduced to its simplest form, at common law a *novus actus* was required, which, as regards personalty usually involved taking possession, though a new deed of transfer would also suffice and possibly an attornment. Then the legal title passed. Equity, on the other hand, recognized the mortgagee's interest as soon as a future item came into the mortgagor's hands without further conveyancing or other steps and priority existed as from the moment of acquisition by the mortgagor. Common law courts did not give effect to equitable mortgages.

The great case of *Holroyd v. Marshall*⁹² ended this dispute in favour of equity. A mortgagee of present and future "machinery implements and things" fixed in or placed about a mill had an equitable title to after-acquired items which the House of Lords held to prevail over an execution creditor. The law report summarizes the illuminating arguments of counsel on the nature of legal and equitable proprietary interests. *Graham* did not apply—the mortgage did not cover *all* present and future property, there was no bankruptcy estate involved and the Holroyds were simply mortgagees for the purchase price.

The principle in *Holroyd* was taken to the House of Lords again in *Tailby v. Official Receiver*⁹³ because Lord Westbury had made certain remarks about specific performance of the mortgage deed, which provoked the Court of Appeal in *Belding v. Read*⁹⁴ to decide that, if for any reason, specific performance were not available, there would be no equitable mortgage (though in *Re Clarke*⁹⁵ Cotton, Bowen and Fry, L.JJ. had refused to countenance *Belding*).

The House of Lords in *Tailby* readily held that a mortgage of future book debts from any business that might be carried on by the mortgagor was not too vague and, following *Holroyd*, became effective as and when debts arose without the need for *novus actus*. All their Lordships' substantive judgments decided that in equity a mortgage of future book

91. *Ibid.*, 105.

92. (1862) 10 H.L.C. 191.

93. (1888) 13 App. Cas. 523.

94. (1865) 3 H. & C. 955; 159 E.R. 812.

95. (1887) 36 Ch.D. 348.

debts attached to them as soon as the debts came into existence on the basis that equity looks upon that as done which ought to be done. There is, however, a small self-contradiction in Lord Macnaghten's judgment on a fundamental point. Near the beginning his Lordship comments on the mortgage in question that:⁹⁶

It belongs to a class of securities of which perhaps the most familiar example is to be found in the debentures of trading companies. It is a floating security reaching over all the trade assets of the mortgagor for the time being, and intended to fasten upon and bind the assets in existence at the time when the mortgagee intervenes. In other words, the mortgagor makes himself trustee of his business for the purpose of the security. But the trust is to remain dormant until the mortgagee calls it into operation.

Later, his Lordship refers to the mortgage "... in equity as a contract binding on the conscience of the assignor and so binding the subject-matter of the contract when it comes into existence".⁹⁷

The inconsistency is that a security cannot both bind future property as soon as it comes into existence and bind it only when the mortgagee intervenes. Lord Macnaghten confuses the operation of a floating charge with that of the traditional mortgage of future property. A mortgagee can before or after default, subject to contractual restraint, express or implied, seize any or all of the mortgaged assets,⁹⁸ while a floating chargee can only enforce the charge over all the charged assets once crystallization has occurred.⁹⁹ Lord Macnaghten's *dicta* in *Tailby* may be one of the causes of the ensuing confusion as to the true nature of the floating charge.

II. CONSTRUCTING THE FLOATING CHARGE

A signal feature of the institution of the floating charge is the absence of clear and accepted definition. As Professor Goode says, its "precise nature . . . remains a matter of controversy".¹⁰⁰ Lord Macnaghten never got beyond purple prose analogy¹⁰¹ and he was not pleased with the institution which he had not managed to define.¹⁰² Paradoxically, this elusiveness is the key to understanding.

In the authors' view the development of the floating charge was much more fraught, and the date of practical completion somewhat later, than current theory allows. The theory, taken from the Genesis, is that: (i) security over present and future property with a dealing power (equated with the *hypotheca*) was impossible at common law and only in 1862 did equity intervene (*Holroyd v. Marshall*); (ii) this case, combined with the Schedule C public utility mortgage over the "undertaking" pointed a way forward which was "promptly"¹⁰³ recognized because in the 1860s mortgages were created over the

96. (1888) 13 App. Cas. 523, 541.

97. *Ibid.*, 543.

98. See, e.g., *Ex p. Dann* (1881) 17 Ch.D. 26 and *Greenbirt v. Smee* (1876) 35 L.T. (N.S.) 168.

99. See, e.g., *Robson v. Smith* [1895] 2 Ch. 118.

100. Feldman & Meisel (eds), *Corporate and Commercial Law: Modern Developments* (1996) 193, 197.

101. See, e.g., *Governments Stock and Other Securities Investment Co. Ltd v. Manila Railway Co. Ltd* [1897] A.C. 81, 86 and *Illingworth v. Houldsworth* [1904] A.C. 355, 358.

102. *Salomon v. A. Salomon & Co. Ltd* [1897] A.C. 22, 53 describing the operation of floating charges in winding up as "a great scandal".

103. Pennington, "Genesis" (1960) 23 M.L.R. 630, 642.

"undertaking" which established the floating charge; (iii) judicial recognition was a little slow and only in *Re Panama, New Zealand and Australian Royal Mail Co.*¹⁰⁴ did the break with earlier cases occur; (iv) the principle in *Panama* was confirmed in *Re Florence Land and Public Works Co.*¹⁰⁵ and *Re Colonial Trusts Corp.*¹⁰⁶ and the floating charge had arrived. It is submitted that the arduous process of constructing the edifice of the floating charge was only finished when all the stages outlined below were completed.

A. *Holroyd*—the "first" case?

While future property covenants had not been considered by the House of Lords in a mortgage context before *Holroyd*,¹⁰⁷ there is otherwise nothing "first"¹⁰⁸ about *Holroyd* at all.¹⁰⁹ The House merely confirmed the unbroken chain of principle running in the equity courts for a very long time, that it was possible to create a mortgage over present and future property, with mortgagor possession and express or implied dealing power, whose validity and priority were expressed when future items came into the mortgagor's hands.

Furthermore, after the Judicature Acts 1873–1875 all divisions of the High Court had to apply this rule.¹¹⁰ The case did not give new impetus to some doctrinal possibility hitherto unknown or merely shadowy. We noted earlier that the heretical doctrine of *Graham v. Chapman* did not impinge upon *Holroyd* itself.

B. Adapting the Schedule C "undertaking" mortgage

In the field of company law the term "undertaking" seems to have been first used by the draftsmen of companies created by Royal charter. A group of people who were formed into a body corporate were commonly referred to as "undertakers", and the meaning of "undertaking" signified something different from merely all the company's assets.¹¹¹ From the latter half of the 18th century the term "undertaking" was borrowed by draftsmen of private Acts of Parliament which incorporated companies to construct public utilities such as canals, railways and waterworks. Parliament included a power in these statutes for the companies to borrow large sums on mortgages of the "undertaking".¹¹² These were eventually standardized in Schedule C of the Companies Clauses Consolidation Act 1845. The courts interpreted such mortgages as over the business as a going concern. They did not give any rights to the mortgagee to enforce the security while the

104. (1870) 5 Ch. App. 318.

105. (1878) 10 Ch.D. 530.

106. (1879) 15 Ch.D. 465.

107. For a consideration of future property covenants in a different context, see the House of Lords' decision in *Bettesworth v. Dean and Chapter of St Paul's* (1728) 1 Bro.P.C. 240; 1 E.R. 541.

108. Pennington, "Genesis" (1960) 23 M.L.R. 630, 634 states that *Holroyd* was the "first leading case in which equity intervened to remedy the defects of the common law".

109. See *Tailby v. Official Receiver* (1888) 13 App. Cas. 523, 535 (Lord Watson), 546 (Lord Macnaghten).

110. *Anon. Case* [1875] W.N. 203.

111. See the Charter of the Mine Adventurers of England, Patent Rolls, 3 Anne. Pt.iii.

112. See, e.g., *Hopkins v. Worcester and Birmingham Canal Proprietors* (1868) L.R. 6 Eq. 437, where the canal company's power to mortgage its undertaking dates from its incorporating statute of 1791. See also the Trent and Mersey Canal statute of 1770.

company continued its business. The mortgagee had no lien over "every spade or barrow which the company may possess"¹¹³ because if it did, and it were enforced, it would paralyse the company's business.

The company's undertaking while it was a going concern would not be allowed to be broken up as the public good would thereby be harmed. The mortgage of the undertaking could not be enforced for public policy reasons, it was not like an ordinary mortgage.¹¹⁴ In the leading case of *Gardner v. London, Chatham and Dover Ry Co.*¹¹⁵ in 1867, a mortgage of the undertaking of a statutory railway company was held not to give the mortgagee an immediate interest *in specie* over all the assets of the company. Cairns, L.J., distinguished away the ordinary commercial mortgage then labouring under *Graham* where mortgagees could "from the first, have asserted their rights as mortgagees by taking and impounding not merely the proceeds of surplus lands, but the capital, the cash balances, the rolling stock, and even their own money advanced".¹¹⁶

The only remedy available for an unpaid mortgagee was against the income of the company by obtaining the appointment of a receiver.¹¹⁷ The mortgage could be enforced once the company's undertaking had ceased.¹¹⁸ While the undertaking continued to trade, the company's assets were still at the mercy of execution creditors but the mortgagees maintained their primacy over such creditors by injunction.¹¹⁹ Execution was only allowed over surplus assets not required for the provision of the public service.

When draftsmen of securities issued over the assets of companies formed under the Companies Acts borrowed the term "undertaking" from the statutory companies,¹²⁰ the courts' interpretation of them relied partly on the established reasoning in the public utility cases, but without applying to Companies Act companies the protection and permanence enjoyed by public utility companies.

In *Re Panama, New Zealand, and Australian Royal Mail Co.*¹²¹ the company's charge was a straight lift from Schedule C. The company relied heavily on the fact that *Gardner* governed the case and that the charge holder could not be allowed to enforce its charge. This argument is not entirely without merit as it can be seen from *Kennedy v. Panama, New Zealand, and Australian Royal Mail Co.*¹²² that the company carried on a business of delivering mail to Australasia and could therefore quite legitimately be regarded as a

113. *Russell v. East Anglian Ry Co.* (1850) 3 Mac. & G. 104, 146; 42 E.R. 201, 217, *per* Lord Truro.

114. In *Marshall v. South Staffordshire Tramways Co.* [1895] 2 Ch. 36, 50, Lindley, L.J., explained the rationale behind the protection of statutory companies: "Speaking generally, the owner of an equitable charge or lien on property as a security for money which is due and payable has a right to a judicial sale of that property in order to satisfy the charge or lien... But this right does not extend to property, of what is called an undertaking, which has been acquired under statutory powers for public purposes, if those purposes will be defeated, or at all events seriously affected, by a judicial sale. This exception to the general rule is as well settled as the rule itself."

115. (1867) 2 Ch. App. 201.

116. *Ibid.*, 217 *per* Cairns, L.J.

117. *Great Eastern Ry Co. v. East London Railway* (1881) 44 L.T. 903.

118. This could be because the company had sold the undertaking and the mortgage could be enforced against the proceeds of sale: *Furness v. Caterham Ry Co.* (1859) 27 Beav. 358; 54 E.R. 140; *Re Woking Urban Council (Basingstoke Canal) Act 1911* [1914] 1 Ch. 300, 314, or because the company was in winding up: *Re Glyn Valley Tramway Co.* [1937] 1 Ch. 465.

119. *Legg v. Mathieson* (1860) 2 Giff. 71; 66 E.R. 31; *Wildy v. Mid-Hants Railway Co.* (1868) 18 L.T. 73.

120. See Edward Manson, "The Growth of the Debenture" (1897) 13 L.Q.R. 418, 420.

121. (1870) 5 Ch. App. 318.

122. (1867) 2 Q.B. 580.

public utility company. The fact that the company was created under the Companies Act rather than a private Act was in later cases not treated as a relevant factor in determining the public nature of the company's business.¹²³ The Court of Appeal decided that there were no public policy considerations to prevent the charge holder from enforcing the charge against the company once it had entered liquidation and therefore ceased to carry on its business. This in itself goes no further than the private Act mortgage cases.

In the words of Giffard, L.J.: "the moment the company comes to be wound up, and the property has to be realized, that moment the rights of these parties, beyond all question, attach. My opinion is, that even if the company had not stopped the debenture holders might have filed a bill to realize their security."¹²⁴ This last sentence is the change from the public utility approach. Either the company being wound up or its entering receivership would lead to the company's inability to carry on its undertaking, which in turn would cause the charge to become enforceable. In modern parlance, it is the inability to carry on its undertaking which causes the floating charge to crystallize.

Although it is generally heralded as the case which introduced the floating charge to fill a yawning gap in the range of secured lending available to companies, *Panama* did no such thing. It largely followed the reasoning in *Gardner* but extended it by lifting the restriction on the enforcement of the charge prior to winding up. This is how the floating charge started. In the authors' view it is one source of the difficulty in settling the precise nature of the floating charge. Giffard, L.J., was presented with a *fait accompli* in that in *Panama* he had to construe a set of words whose meaning was largely driven by questions of public policy when translated to a context in which that public policy was not merely not decisive but actually inappropriate. The traditional law of bills of sale would not be a useful guide because "undertaking" was not used in such bills and would be inapposite in the case of an individual trader executing a bill over all his present and future property.

C. Schedule C mortgages under the Companies Acts

Although Professor Pennington suggests that after *Holroyd* businessmen "promptly"¹²⁵ appreciated the possibilities of allying this decision to the Schedule C mortgage of the "undertaking", because debentures based upon this approach appeared in the 1860s, the first debenture he discusses is from 1859,¹²⁶ which pre-dates *Holroyd*. In the authors' view, the undertaking mortgage derived from Schedule C was attractive to a company's advisers in 1859 for entirely different reasons. Although the meaning of Schedule C was not fully worked out in 1859 in relation to public utilities,¹²⁷ the courts had been at one in thinking that the mortgage did not impede the carrying on of business. In 1859 that was important because financing of unincorporated trade was being utterly plagued by *Graham*

123. See *Blaker v. Herts and Essex Waterworks Co.* (1889) 41 Ch.D. 399 and *Marshall v. South Staffordshire Tramways Co.* [1895] 2 Ch. 36.

124. (1870) 5 Ch.App. 318, 322-323.

125. (1960) 23 M.L.R. 630, 642.

126. *King v. Marshall* (1864) 33 Beav. 565; 55 E.R. 488.

127. See generally C. Stebbings, "Statutory Railway Mortgage Debentures and the Courts in the Nineteenth Century" (1987) 8 J. Legal Hist. 36.

under Jervis, C.J.'s "paralysis" argument in the case of mortgages over all present and future property.

Bearing in mind (a) that mortgages of all present and future property with express or implied power in the mortgagor to deal with it in the ordinary course of business had always been the central mechanism of the trade financing system and (b) that company registrations started to increase after the Limited Liability Act 1855,¹²⁸ it was not long before the "paralysis" argument started to surface in corporate financing. Both Jessel, M.R.,¹²⁹ and Giffard, L.J.,¹³⁰ argued the point when counsel. It was accepted in the leading Schedule C mortgage case of *Gardner v. London, Chatham and Dover Ry.*¹³¹ Jessel, M.R., put it in his judgment in *Florence Land*¹³² and it is still repeated in modern times.¹³³

The source of this doctrine is *Graham* (discounting isolated earlier cases such as *Hassells v. Simpson*).¹³⁴ The important point is that it was good law in bankruptcy from 1852¹³⁵ and corporate mortgages were not intrinsically immune to the doctrine. In 1879, the year after *Florence Land*, Baldwin¹³⁶ cited it as authority for the following proposition:

Even though there be a *present* advance, if the assignment operate so as to convey the *whole* of the existing property, and *also* to vest in the assignee specific property as and when such should be subsequently acquired, it is probably an act of bankruptcy, as the present advance would generally only purchase property for the assignee.

In the case of private Act public utilities, a mortgage over the "undertaking" implied that the company could go on because public policy required the utility to continue its activities for the public good. Advisers to Companies Act companies were presumably hoping that the public utility interpretation of "undertaking" would be applied to the debentures of such companies and, given the constant attempts being made to avoid the sheer inconvenience of *Graham*, felt it was worth trying.

128. Figures provided by Companies House show that there were 5,000 incorporations in the period 1862–1869, 9,900 in the 1870s, 18,000 in the 1880s, 36,600 in the 1890s and 45,000 in the first decade of the 20th century.

129. *King v. Marshall* (1864) 33 Beav. 565.

130. *Re Marine Mansions* (1867) L.R. 4 Eq. 601.

131. (1867) 2 Ch.App. 201, 217, *per* Cairns, L.J.

132. (1878) 10 Ch.D. 530 (*supra*, fn. 105).

133. See, e.g., *Wheatley v. Silkstone and Haigh Moor Coal Co.* (1885) 29 Ch.D. 715, 719, *per* North, J.; *Re Yorkshire Woolcombers' Assn Ltd* [1903] 2 Ch. 284, 296, *per* Romer, L.J.; *Re Benjamin Cope and Sons Ltd* [1914] 1 Ch. 800, 805–806, *per* Sargant, J.; and *Re Croftbell Ltd* [1990] B.C.L.C. 844, 847, *per* Vinelott, J.

134. (1785) 1 Doug. 89, 92, where Lord Mansfield stated: "... if a trader makes a conveyance of all his property, that is, instantly, an act of bankruptcy. It is fraudulent: it destroys the capacity of trading. In this case, [the mortgagor] could not fairly sell an ounce of merchandize after the assignment. The whole belonged to another man." See also *Maugham v. Sharpe* (1864) 17 C.B. (N.S.) 443; 144 E.R. 179, where the common law court held that a subsequent mortgagee had no interest in property subject to a prior mortgage, because at the time the mortgagor executed the subsequent mortgage, he had no interest left in the property as he had already transferred it to the first mortgagee.

135. *Hutton v. Cruttwell* (1852) 22 L.J.Q.B. 78. The court distinguished *Graham* but "without impeaching" its authority (*per* Lord Campbell, C.J., at 80).

136. E. T. Baldwin, *The Law of Bankruptcy* (London, 1879), 26 (emphasis in original). See also *Williams on Bankruptcy* (London, 1884), 11–15, recounting the effects of *Graham* and the overruling of it in *Ex p. Hauxwell* (1883) 23 Ch.D. 626.

D. *Panama* confirmed by *Florence Land*?

Although *Re Florence Land and Public Works Co.*¹³⁷ confirms *Panama*, it is not an unreserved confirmation. After considering the terms of the company's articles, which were expressly mentioned in the debenture document, Jessel, M.R., held on the facts that the charge on the "estate, property and effects" was to be interpreted as "a security on the property of the company as a going concern, subject to the powers of the directors to dispose of the property of the company while carrying on its business in the ordinary course".¹³⁸ In contrast to Jessel, M.R., James, L.J., equated "estate, property and effects" with "undertaking"¹³⁹ (a seemingly small expansion in the meaning of those words) and stated: "I am of opinion that the law does allow such a company as this to charge its undertaking, meaning by 'charging the undertaking' charging the assets for the time being."¹⁴⁰ The two judges therefore arrived at the same point but by a slightly different route. It is important to note that security over the "undertaking" was, and is, unknown to the financing of the unincorporated trade sector. It could conceivably be used to sidestep any possible problems thrown up by *Graham* as being outside the grasp of the law on individual insolvency.

In his judgment Jessel, M.R., drew a distinction between the type of charge created on the facts of *Florence Land* (shortly thereafter to become known as a floating charge) from the more conventional specific type of security:¹⁴¹

It is therefore inconsistent to suppose that the moment you executed a bond or debenture you paralysed the company and prevented it carrying on its business, for if you read the words to mean a specific charge on the property of the company, then, of course, no practical use could be made of the money borrowed, because that would become the property of the company, and anybody with notice would be liable on that view to repay it to the mortgagee or debenture holder.

The theory that fixed charges, by definition, prevent dealing and cause paralysis of the company's business with regard to the charged assets has this statement as its origin. Jessel, M.R.'s *dictum* is a clear reflection of Jervis, C.J.'s views in *Graham* that the deed "... passes, not only all the trader's stock, and the money advanced, if he then had it in his possession, but it also professes to give the defendant a right to take all future-acquired property, even though it should be purchased with the money which is alleged to be the consideration for the transfer"¹⁴² and that "... [the trader] had legally no power to continue his trade, or to dispose of a single article of his stock, if the deed was good".¹⁴³

It is significant that James, L.J., upheld the debenture in *Florence Land* "... because the things are given for money lent, and therefore the company and the creditors of the company have had the benefit of the money".¹⁴⁴ The benefit-of-the-money argument was one of the devices employed by the bankruptcy courts to sidestep the principle in

137. (1878) 10 Ch.D. 530.

138. *Ibid.*, 540-541.

139. *Ibid.*, 546.

140. *Ibid.*

141. *Ibid.*, 541.

142. (1852) 12 C.B. 85, 104.

143. *Ibid.*, 102.

144. (1878) 10 Ch.D. 530, 546.

Graham.¹⁴⁵ Although the judgments in *Florence Land* show a willingness to follow Giffard, L.J.'s lead in *Panama*, a fresh question mark was placed over the future of the floating charge. Both Jessel, M.R.,¹⁴⁶ and James, L.J.,¹⁴⁷ expressly reserved the question of what effect the Judicature Act 1875, s. 10 had on the floating charge. This reservation did not so much strengthen the *Panama* case as threaten it with extinction. This will be considered under the next heading.

E. Judicature Act 1875, s. 10

The provision in the Judicature Act 1875, s. 10 applied the bankruptcy law to insolvent winding up with regard to "the respective rights of secured and unsecured creditors". It was a troublesome piece of drafting.

In *Re Printing and Numerical Registering Co.*¹⁴⁸ Jessel, M.R., said of it: "In putting a construction on obscure enactments or instruments no single Judge is entitled to say another is wrong; all he can say is that he differs from the other Judge as to the meaning of the obscure enactment or instrument before him." In *Re David Lloyd & Co.*¹⁴⁹ his Lordship also stated: "... by virtue of sect. 10 of the Judicature Act 1875, the law as to secured creditors is the same in winding up as in bankruptcy. The Companies Act, so far as it is inconsistent with the law of bankruptcy, is repealed."

Although his Lordship refused to import into winding-up law the Bankruptcy Act 1869, ss 15 and 32 (to the effect that property in the reputed ownership of the bankrupt passed to the trustee in bankruptcy and that certain debts such as local rates were to be treated as preferential in bankruptcy), he did apply s. 87 (that in bankruptcy an execution creditor for more than £50 loses the benefit of his execution if the sheriff, within 14 days after a sale, has notice of the bankruptcy) in the liquidation of a company.¹⁵⁰ The reason for raising s. 10 here is that in the reported argument in *Florence Land*¹⁵¹ Jessel, M.R., questions counsel as follows:

Can a company, any more than an individual, charge its future property? This is not a charge on the "undertaking" as in other debentures, but on the "estate, property and effects". By the Judicature Act 1875 s. 10, the administration of the estates of companies in winding up has been assimilated as to the respective rights of secured and unsecured creditors to the administration of estates in bankruptcy. Would it not be contrary to the policy of the bankruptcy laws that a mortgage security should affect after-acquired property?

The form of the questions put—can the company charge future property and is it not contrary to the policy of the bankruptcy laws to do so?—coupled with the distinction expressly taken between "undertaking" and "estate, property and effects" point directly to Jervis, C.J.'s judgment in *Graham*, in which it was held that a mortgage of all present

145. See, e.g., Willes, J., in *Lomax v. Buxton* (1871) 6 C.P. 107, 113.

146. (1878) 10 Ch.D. 530, 543.

147. *Ibid.*, 547.

148. (1878) 8 Ch.D. 535, 538.

149. (1877) 6 Ch.D. 339, 342–343.

150. In *Re Crumlin Viaduct Works Co.* (1879) 11 Ch.D. 755; *Re Albion Steel and Wire Co.* (1878) 7 Ch.D. 547 and *Re Printing and Numerical Registering Co.* (1878) 8 Ch.D. 535 respectively.

151. (1878) 10 Ch.D. 530, 535.

and future property was at common law a fraud on the bankruptcy laws which by itself invalidated the mortgagee's security and stopped the business.

Jessel, M.R.'s question is not directed at the order and disposition clause¹⁵² because it is an essential pre-condition of applying the clause that the mortgage is valid and the mortgagee's title is good, otherwise the mortgagee could not be the "true owner" for the purposes of the clause. Jessel, M.R., clearly appreciated the danger that the principle in *Graham* (which destroyed the dealing power in cases of all present and future property security, paralysing the business and necessitating security holder consent to all dealing) might apply to companies through the operation of the Judicature Act.

This was not a welcome prospect and Jessel, M.R., attempted to prepare the ground by suggesting that the security in *Florence Land* was unattached (in the *Panama* sense). James, L.J., in equating "estate, property and effects" with "undertaking",¹⁵³ opened up a possible argument that, since "undertaking" was not a feature of individual security law, there was nothing in the bankruptcy law to import into the winding-up law. The question reserved by Jessel, M.R.,¹⁵⁴ and James, L.J.,¹⁵⁵ left open the possibility that s. 10 could strike down even floating security. The reserved question, however, was not argued because, as the last paragraph of the law report shows, the parties came back with a settled form of order.¹⁵⁶

The question of mortgages over all present and future property and s. 10 was disposed of in 1885. In *Re Mersey Wood*,¹⁵⁷ Kay, J., accepting a distinction between "undertaking" and "estate, property and effects", made two points: (i) the mortgage validity issue was not covered by any provision in the Bankruptcy Act itself, so there was nothing for s. 10 to import into the winding-up law (this, if we may respectfully say so, must be correct—Jervis, C.J.'s judgment in *Graham* is on the common law of bankruptcy, not the statute); and (ii) the only Bankruptcy Act provision dealing with such mortgages was the order and disposition clause and there were no materials before the court to raise that clause.

The Irish Court in 1884 also considered Jessel, M.R.'s question in *Re Dublin Drapery Co.*¹⁵⁸ There debentures had been issued in 1876 over the "undertaking, stock in trade, lands, premises, works, plant, property and effects (both present and future)" of the company. The effect of the Irish equivalent of s. 10 was raised. In answer to whether or not a company, any more than an individual, could charge its future property, the court found no shortage of corporate and individual authorities,¹⁵⁹ untainted by s. 10 or

152. A suggestion made by Dr Gough in *Company Charges*, 2nd edn (London, 1996), 53, but difficult to justify, given Jessel, M.R.'s clear opinions expressed only four months after *Florence Land* in *Re Crumlin Viaduct Works Co.* (1879) 11 Ch.D. 755, 758–759, where his Lordship refers to the "utter absurdity" of the result of such a suggestion.

153. (1878) 10 Ch.D. 530, 546.

154. *Ibid.*, 543.

155. *Ibid.*, 547.

156. *Ibid.*, 550.

157. (1885) 1 T.L.R. 566.

158. (1884) I.R. 13 Ch.D. 174.

159. E.g., *Holroyd v. Marshall* (1862) 10 H.L.C. 191; *Clements v. Matthews* (1883) 11 Q.B.D. 808; *Collyer v. Isaacs* (1881) 19 Ch.D. 342; *Re Marine Mansions* (1867) L.R. 4 Eq. 601; *Re Panama, New Zealand and Australian Royal Mail Co.* (1870) 5 Ch.App. 318, and *Re Florence Land and Public Works* (1878) 10 Ch.D. 530.

Graham, where such securities had been found to be valid, either in the form of a mortgage of specified property or as a floating charge over a company's undertaking.

The traditional future personalty mortgage with dealing power and the floating charge were extricated from *Graham* in 1883¹⁶⁰ and s. 10 in 1885.¹⁶¹ Thereafter any suggestion that a company could not specifically mortgage all its present and future property and still maintain a power to deal with those assets must be mistaken. Nevertheless, Jessel, M.R.'s views on the paralysing effect of specific security (which accurately represented the *Graham* principle which was law at the time) continue up to the present day. Thus *Graham*, despite having only a brief and troubled lifespan of 31 years, continues to haunt the law of corporate security over 100 years after reports of its death.

In the authors' submission the principle of *communis error facit ius* is not a sufficient answer to this issue because the courts have never adopted a single approach to the dealing power¹⁶² and the law on specific and floating security remains uncertain.¹⁶³

F. Bills of Sale legislation 1882

Even before the traditional mortgage bill of sale and floating charge were rescued from *Graham* and s. 10, they became embroiled in something far worse—the Bills of Sale Act (1878) Amendment Act 1882. Commercially speaking, the traditional mortgage did not recover and it took some years for the floating charge to emerge safely. The authors have considered this issue elsewhere,¹⁶⁴ so that a bare outline only is tendered here.

Security bills had to conform to a statutory model which, with few exceptions, did not permit security over future property to be taken. From the company law standpoint, there was an important saving in s. 17 for "debentures issued by any mortgage, loan or other incorporated company" which were "secured upon the capital stock or goods, chattels, and effects of such company". By the end of the 1880s s. 17 was in dire straits as serious doubts surrounded the above expressions. In two cases¹⁶⁵ it had been held that "other incorporated company" did not mean any incorporated company but only one which was *eiusdem generis* with a "mortgage" or "loan" company (whatever that was). In one of them, *Jenkinson v. Brandley Mining Co.*,¹⁶⁶ Grove, J., was close to propounding a sinful theory of the development of the floating charge, namely an attempt to assume (and pervert) the public policy based injunctive rights of a public utility Schedule C mortgagee against would-be execution creditors, with the consequence that any ordinary trading company with co-operative debenture holders could trade on free from creditor enforcements (described by Grove, J., as a "manifest injustice"¹⁶⁷).

160. By the Court of Appeal overruling *Graham* in *Ex p. Hauxwell* (1883) 23 Ch.D. 626.

161. Kay, J., in *Re Mersey Wood* (1885) 1 T.L.R. 566.

162. See, e.g., *Holroyd v. Marshall* (1862) 10 H.L.C. 191; *Tailby v. Official Receiver* (1883) 13 App. Cas. 523; *Taylor v. Bank of New South Wales* (1886) 11 App. Cas. 596; *Re Atlantic Computer Systems Plc* [1992] Ch. 505; *Re Atlantic Medical Ltd* [1992] B.C.C. 653; *Re Cimex Tissues Ltd* [1994] B.C.C. 626; and Goode, *Legal Problems of Credit and Security*, 2nd edn (London, 1988), 56.

163. See, e.g., R. Gregory and P. Walton, "Book Debt Charges—The Saga Goes On" (1999) 115 L.Q.R. 14.

164. R. Gregory and P. Walton, "Fixed Charges over Changing Assets—The Possession and Control Heresy" [1998] CflLR 68.

165. *Brocklehurst v. Railway Printing and Publishing Co.* [1884] W.N. 70 and *Jenkinson v. Brandley Mining Co.* (1887) 19 Q.B.D. 568.

166. (1887) 19 Q.B.D. 568.

167. *Ibid.*, 571.

In 1891 in *Re Standard Manufacturing Co.*¹⁶⁸ (in judgments which owed more to the wisdom of the judges than that of the legislators) the Court of Appeal resolutely plucked the trade financing system from its predicament. It is worth noting that Bowen, L.J.'s ground of decision¹⁶⁹ was that bills of sale issued by companies were not subject to the Bills of Sale Act 1878 and therefore the 1882 Act was inapplicable to such bills. One consequence of this is that present and future property mortgages issued by companies are almost exclusively governed by the principles of common law and equity rather than statute. In the authors' view it was *Standard Manufacturing* which established the charge on the "undertaking and all its property both present and future" in an undoubted niche in both law and commercial practice.

III. HOLROYD AND THE HYPOTHECA

Both Professor Pennington¹⁷⁰ and Professor Goode¹⁷¹ tie the juridical nature of the floating charge to the *hypotheca* and see *Holroyd* as the instrument by which the *hypotheca* surfaced in English law. In the authors' submission *Holroyd* is nothing to do with the *hypotheca* and, insofar as a Roman originating analogy is apposite, it is to be found elsewhere.

Holroyd involves a mortgage of chattels and its ancestry is not the *hypotheca* (nor the *pignus*) but is in fact the *venditio*. Dean Wigmore¹⁷² provided excellent insights into the Roman use of the institution of sale as a mechanism for creating a mortgage. He describes the difficulty experienced in Roman law in returning to the debtor the surplus above the mortgagee's proper monetary entitlement and discusses the role of the *commisaria* and *fiducia* in achieving that end.

From early times the English mortgage was a sale transferring title to the mortgagee subject to defeasance on payment of the amount reserved by the agreement. The concept of the equity of redemption efficiently protected, *inter alia*, the surplus on realization for the debtor. While the common law courts and the equity courts expounded the mortgage, the serious differences between them have been discussed earlier. All that *Holroyd* did was to give primacy to the equity side. At no point was *Holroyd* concerned with *hypotheca*. This raises a second point. The reason that the *hypotheca* had not been an issue in English law was that it had nothing to offer commercial people which they did not in practice enjoy through the present and future personalty mortgage bill of sale with dealing power.¹⁷³

Principles, well honed, much older and much more fundamental to the common law and equity, were (and are) at work in giving effect to the personalty mortgage as a means of combining specific security with the power to deal. As Maitland¹⁷⁴ points out, seisin was

168. [1891] 1 Ch. 627.

169. *Ibid.*, 645.

170. "The Genesis" (1960) 23 M.L.R. 630, 634.

171. Feldman & Meisel (eds), *Corporate and Commercial Law: Modern Developments* (1996) 193, 195.

172. "The Pledge-Idea: A Study in Comparative Legal Ideas. III." (1897) 11 Harv.L.R. 18, 21-36.

173. Advocates of the idea of importing the *hypotheca* into English law are not thick on the ground. In 1686, however, Malynes suggested adoption of a form of *hypotheca* at that time in use in Europe: Malynes, *Lex Mercatoria* (London, 1686), 153, under the heading "Of Merchant's Oppignorations".

174. "The Seisin of Chattels" (1885) 1 L.Q.R. 324.

not just a real property notion, and although later "possession" took over, seisin and possession in relation to personal chattels meant the same thing.

Because of the central role of possession and transfer of it in the nature of title to chattels and their transfer, in the early days (before conversion) even a tortious taker had seisin and could transfer it to a third party. The transfer of possession with the intent to pass title would in most circumstances pass title to the transferee. This basic concept, nowadays shorn of its medieval complexities and the forms of action, is still at work—although, in fairness, it was precisely these complexities and the forms of action which provoked early judges and writers into highly developed analysis of the nature of personal property interests.¹⁷⁵

Thus, extrapolating from cases such as *Ryall v. Rolle*,¹⁷⁶ *Joseph v. Lyons*,¹⁷⁷ *Hallas v. Robinson*¹⁷⁸ and *Re Neal*,¹⁷⁹ the mortgagor had a bare legal title to future acquired chattels; he also had possession of all mortgaged property and, acting under the express or implied power to deal, he was perfectly able under a sale to transfer possession and title to items of the mortgaged chattels to a buyer.

The basis of the buyer's title here is: (i) not that the mortgagor has no title to transfer to the buyer but the mortgagee is estopped from denying the buyer's interest; but rather (ii) that the mortgagor has sufficient of the elements of a disposable title in his hands plus the right to transfer, so that he can make a full title. These elements are actual possession, a right to possession and a right to transfer possession and title. The mortgagor is no more and no less than a seller in possession at common law.¹⁸⁰ It is no accident, therefore, that both the common law judges and Lord Hardwicke on the equity side in *Ryall v. Rolle*¹⁸¹ said that Harvest, the mortgagor, could turn over mortgaged stock in trade in the course of his business. Lush, J., was similarly following these fundamental principles when in *National Mercantile Bank v. Hampson*¹⁸² he said that a purchaser under a bona fide sale would acquire a good title (note: this is not the equitable doctrine of bona fide purchaser of the legal title for value without notice). Powell on *Mortgages*¹⁸³ takes the same view when discussing the order and disposition clause.

Thus the incidence of the personalty mortgage, either in the form of a sale subject to defeasance on payment or (later) a proviso for re-assignment on redemption, was fully able to accommodate the mortgagor's ability, under common law rules as to passing of property in chattels, to make title to, say, stock in trade to a buyer under a contract of sale.

175. A basic introduction may be found in F. Maitland, "The Seisin of Chattels" (1885) 1 L.Q.R. 324; J. B. Ames, "The Disseisin of Chattels" (1889) 3 Harv.L.R. 23, 313, 337; F. Pollock, "Gifts of Chattels Without Delivery" (1890) 6 L.Q.R. 446 (and the judgment in *Cochrane v. Moore* (1890) 25 Q.B.D. 57, to which Pollock's piece is a note); and the sources referred to in these materials. R. L. V. Williams, *Law of Personal Property* (London, 1848) is also instructive. S. D. Roper, *A Treatise on the Law of Property, arising from the relation between husband and wife* (London, 1820), contains useful analysis on the equity side.

176. (1749) 1 Atk. 165.

177. (1884) 15 Q.B.D. 280.

178. (1884) 15 Q.B.D. 288.

179. [1914] 2 K.B. 910.

180. In *Colonial Bank v. Whinney* (1886) 11 App. Cas. 426, 435–456, Lord Blackburn accepted that the result of applying either of the two principles was very similar, citing his *dicta* in *Cole v. North Western Bank* (1875) 10 C.P. 354, 362. The mortgagor is not carrying on business as agent for the mortgagee but in his own behalf: see *Joseph v. Lyons* (1884) 15 Q.B.D. 280, 285 *per* Brett, M.R.

181. (1749) 1 Atk. 165.

182. (1880) 5 Q.B.D. 177.

183. T. Coventry (ed.), J. J. Powell, *A Treatise on the Law of Mortgages*, 6th edn (London, 1826), 42.

This state of affairs was generally what both the mortgagor and mortgagee wanted, because only by continuing in trade would the debtor be able to repay and, as Lindley, J., pointed out,¹⁸⁴ without the power to deal the bill of sale would be worthless.

The *hypotheca* had not taken off in England because the mortgage law satisfied commercial requirements.¹⁸⁵ *Holroyd* merely made the efficacy of such mortgages unassailable by upholding the old equity principles. The vexed question of possession and control and the power to dispose in the current book debt charge debate is irrelevant to the institution of the mortgage.

IV. A FEW REFLECTIONS

Although the authors appear to have done their best to disguise it, their purpose in writing this article is strictly modern. If we may pay a final tribute to the perspicacity of the simpler ancients, it is that the mortgage covering present and future property with an express or implied dealing power is, quite simply, vastly superior to the floating charge in satisfying the *current* commercial needs of both borrowers and lenders.

In a valuable passage in the *Exodus*,¹⁸⁶ Professor Goode describes seven legal conditions essential to maximize any company's ability to raise funds on the security of its enterprise, precised here as: (1) the company retains possession of trade assets; (2) intangible assets are susceptible of charge; (3) future property is included to catch circulating assets; (4) security is grantable over all, or classes of, the assets rather than by individual identification; (5) present and future advances are within the security; (6) security over circulating assets avoids business paralysis and allows free disposal in course of business; and (7) priority of purchase-money security to avoid first financier monopoly.

At the time of its commercial demise as a result of the Act of 1882 the mortgage of present and future personalty (including debts) had held a pre-eminent position as *the* mechanism for secured loan financing to trade and business since the Middle Ages. It had developed to the following pitch:

- the mortgage could cover present and future property;
- individual identification of assets was not essential—class description sufficed, as did the global “all”;
- further advances could be included;
- intangible assets were mortgaged from the very beginning;
- the mortgagor almost always kept possession of the assets;
- there was a power to deal, express or implied;
- in cases of land equity had shown some tenderness toward the mortgagee for the purchase price and in *Re Connolly Brothers Ltd (No. 2)*¹⁸⁷ it was held that in

184. *Walker v. Clay* (1880) 49 L.J.Q.B. 560, 561.

185. The authors are very grateful to Dr Trevor Hart, Chief Archivist of ANZ Grindleys Bank, who very kindly supplied us with a copy of an Australian mortgage over a fluctuating herd of cattle from 1857. We are also very grateful to Dr John Booker, Chief Archivist of Lloyds Bank Plc, who gave us access to archives of the bank which contain a number of examples of mortgages of fluctuating personal property including debts from the middle of the 19th century.

186. Feldman & Meisel (eds), *Corporate and Commercial Law: Modern Developments* (1996) 193, 194.

187. [1912] 2 Ch. 25.

simultaneous purchase and mortgage cases the mortgagor beneficially acquired only the equity of redemption. These developments might have matured further to meet Professor Goode's "first financier monopoly" problem in his seven optimum conditions in his *Exodus*; a good opportunity to do this was lost in *Stroud Architectural Systems Ltd v. John Laing Construction Ltd*;¹⁸⁸

- business was not paralysed by the execution of the mortgage right from the earliest times; except for a tiny number of cases of the *Hassells v. Simpson*¹⁸⁹ type, from which Lord Kenyon rescued mortgages in *Whitwell v. Thompson*,¹⁹⁰ and the very damaging *Graham v. Chapman*¹⁹¹ interlude, nearly all the reported cases cited hitherto involved the turning over of the mortgaged property in the course of business. Phillip E. Jones¹⁹² and Dr A. H. Thomas¹⁹³ report the same state of affairs in their discussions of the 15th century practice. Unlike the landed aristocracy, many traders had only their stock in trade, debts, trade implements and household contents to offer as security. Furthermore, the writings of Postan¹⁹⁴ and Dr Nightingale,¹⁹⁵ referred to earlier, demonstrate the economic conditions which rendered such forms of mortgage necessary.

In the result the nation traded, borrowed, mortgaged and traded the security on without much legal hindrance for 500 years without the *hypotheca*. Despite the simplicity of the ancients, they very nearly achieved all of Professor Goode's optimum conditions. By contrast, the floating charge is still wholly unsettled as to its fundamental nature. Discussion of it is notable for confusion and contradiction. While the accepted theory is intellectually satisfying, in that it poses an expressed commercial need which received a requisite legal response, the actual development of the floating charge does not fit the theory. Moreover, it was a lame and lurching affair.

Nevertheless, Professor Goode is quite right to say that commercial law developments are prompted by commercial needs and it is no part of the argument here to say that the floating charge was always mere surplusage. In the authors' view, however, the position was not that suddenly there was a need for security with dealing power and nothing was in place at the time, but rather that the all present and future property mortgage with dealing power had been in place for a very long time, when it was wrested from its central position in the trade financing system by the common lawyers in *Graham v. Chapman*.

The borrowing of the Schedule C mortgage was no more than an attempt on the part of those advising financiers to the newly emerging corporate trade sector to ward off the unfortunate effects which Jervis, C.J.'s judgment in *Graham* was having on the unincorporated sector. As things turned out it was an inspired attempt.

The courts' difficulties in trying to formulate floating charge principles stem from: (i) the paramount public policy concerns which imbued the meaning of the Schedule C

188. [1994] B.C.C. 18.

189. (1785) 1 Doug. 89.

190. (1793) 1 Esp. N.P.C. 68.

191. (1852) 12 C.B. 85.

192. "Introduction: Gifts of Goods and Chattels", in *Calendar of Select Pleas and Memoranda of the City of London 1437-1457* (Cambridge, 1954).

193. "Introduction: Gifts of Goods and Chattels," in *Calendar of Select Pleas of Memoranda of the City of London 1413-1437* (Cambridge, 1943).

194. *Supra*, fn. 14.

195. *Supra*, fn. 16.

mortgage but were wholly inapposite to an ordinary Companies Act company; (ii) the pervasive influence of a long history of mortgage bills of sale with express or implied dealing power; and (iii) the *Graham* paralysis heresy, which in the 1860s and 1870s the courts had to accept as good law, although struggling determinedly to circumvent it, until it was overruled in *Hauxwell*.

The difficulty with 20th century understanding of the floating charge is that the paralysing effect of specific security referred to in early floating charge cases (when *Graham* was a live issue) retains life and force as an element in legal thought today notwithstanding that it was expunged from the law in 1883. This oversight is entirely understandable, however, because Lord Lindley's restoration of the mortgage law to its proper state in *Hauxwell* arrived at roughly the same time as trade financing ceased to operate through bills of sale mortgages because the legislation of 1882 destroyed their commercial efficacy. It may even be that the strong upturn in company registrations after this time was a response to the finance requirements of those conducting business. The state of the mortgage bills of sale law would not be an everyday matter in the minds of those involved in company financial instruments for very long after the 1882 statute.

The superiority of the mortgage with express or implied dealing power over the floating charge lies in its greater subtlety, flexibility and safety of dealing:

- (1) Subject to considerations such as jeopardy, the floating chargee generally has to wait until crystallization to protect or realize the security. Mortgages, in the absence of express terms, do not carry that restraint.
- (2) One of the dangers of clauses giving rise to automatic crystallization is that accidental crystallization can occur. This is not a feature of the mortgage.
- (3) Crystallization which is accidental and unappreciated by the parties involves messy (in commercially practical terms) problems of safety of dealings with third parties, directors' authority, estoppel, possible refloating and title to property. Again this is not a mortgage problem.
- (4) Floating charges are equitable and through the registration provisions of the Companies Act 1985, ss 395–401 everyone who deals with the company risks the requirements of the bona fide purchaser for value of the legal title for safety of dealing. True safety consists in enquiry of the chargee.

Mortgages provide a safer dealing power so far as third parties are concerned. The reason is that the bill of sale mortgage is a sale in which the mortgagor has possession, a right of possession under the express or implied dealing power and a right to transfer a title arising also from that power. Thus, at common law, not statute, the mortgagor can make a good title. The principle of the bona fide purchaser of the legal title for value without notice is not, therefore, constantly in play in relation to personal property. Land conveyancing involves separate issues. The mortgagor is at common law a seller in possession.

- (5) When crystallization occurs, it affects all the assets to which the floating charge applies (unless partial crystallization becomes a settled institution). Mortgagees and mortgagors are not so hamstrung because the mortgagee can dip into the assets mortgaged and take a fraction even though the mortgage is expressed to apply to all present and future property.¹⁹⁶

196. See, e.g., *Ex p. Dann* (1881) 17 Ch.D. 26 and *Greenbirt v. Smea* (1876) 35 L.T. (N.S.) 168.

- (6) As Dr Oditah¹⁹⁷ rightly expresses it, the effect of crystallization is to bring “management autonomy” over the assets to an end. Under a mortgage, a mortgagee can dip in and leave management autonomy otherwise unaffected.
- (7) A potentially serious practical problem in receivership arises from *Re Real Meat Co. Ltd.*¹⁹⁸ Chadwick, J. (as he then was) held that, where a receiver is appointed under a second charge, a sale by the receiver in the course of realization does not overreach the prior charge. In that case a bank had financed on secured terms the buyout by a new company formed by the management of the old company. It was held to be constructive trustee for the prior charge holder of the proceeds of the old company’s book debts which the receiver had sold to the new company and which were charged to the bank. The court considered that, unless the overreaching provisions of the Law of Property Act 1925 could be invoked (and they could not), the receiver’s statutory power of sale under the Insolvency Act 1986¹⁹⁹ was not sufficient to achieve that effect. The inconvenience of this decision to a trading receivership is obvious and considerable. In relation to the old bill of sale type mortgage of present and future property with express or implied dealing power, this issue does not arise. A five-member Court of Appeal settled the principle in *Re Morritt*.²⁰⁰ It was held there that a personalty mortgage implies a power to realize by sale. In particular, the court held that the provisions of the statutory predecessor to the 1925 Act (the Conveyancing and Law of Property Act 1881) were neither relevant nor necessary to achieve a fully effective sale.

Compared with the mortgage, the floating charge is a crude and blunt instrument. For those seeking a more subtle, flexible, lender-efficient and management-friendly form of security instrument for the 21st century—there is a strong case here for looking backwards in order to move forward.

197. F. H. Oditah, *Legal Aspects of Receivables Financing* (London, 1991), 111.

198. [1996] B.C.C. 254.

199. Sched. 1, para. 2.

200. (1886) 18 Q.B.D. 222.

Preferential Debts: An Empirical Study

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Introduction

Recently the then Secretary of State for Trade and Industry, Peter Mandelson M.P., made some comments at the Confederation of British Industry's Annual Conference which have reopened the debate as to whether the Crown should enjoy any preferential position when it comes to the distribution of the assets of companies which are in insolvent liquidation.¹ The Secretary of State said that he was going to earnestly consider the abolition of such preferential treatment. Subsequently, the Treasury has indicated its resistance to such a move, and the National Audit Office² and the House of Commons Public Accounts Committee³ have urged government departments to be more aggressive in pursuing debts owed by insolvent companies.⁴

The general rule, known as the *pari passu* principle and embodied in section 107 of the Insolvency Act 1986 for voluntary liquidations and in rule 4.181(1) of the Insolvency Rules for compulsory liquidations, as far as the distribution of assets in a liquidation is concerned is that the company's property is to be applied equally towards its liabilities. The principle of equality of division among creditors is one of the (if not the most) fundamental principles of the law of liquidation (and of insolvency in general)⁵ and is at the very heart of the whole statutory scheme of winding up. The idea of giving certain creditors preferential treatment is, therefore, an exception to the general rule which has attracted widespread and sustained support over the years.

While the granting of preferential treatment to some creditors of insolvents is an exception to the inveterate *pari passu* principle, it must be acknowledged that the concept of preferential status has a long lineage, emanating initially from the Crown's ancient prerogative rights.⁶ However, after recognising the longevity of preferential treatment, it seems that the development of the law dealing with preferences has largely been an accident of history rather than a matter of policy. There were minor changes to the preferential debts regime as a result of the reports of the Warmington,⁷ Cohen⁸ and Blagden⁹ Committees but only the Report of the Cork Committee¹⁰ looked at the issue in any real depth and led to significant reform. For instance, the recommendations of the Cork Report led eventually¹¹ to the provisions of the Insolvency Act 1986 ("the Act") curtailing the preference to which the Crown was entitled. The preferential debts regime is now found in section 386 of and Schedule 6 to the Act. Notwithstanding the reform of

¹ See Wighton, "Tax bodies may lose preferential creditor status", *Financial Times*, November 3, 1998.

² H.C. 695 Session 1995/96, "Redundancy Payments Service: Management and Recovery of Debt".

³ H.C. 1998 Eighteenth Report, "The Department of Trade and Industry Redundancy Payments Service: The Management and Recovery of Debt".

⁴ See Atkinson, "Soft line on bankruptcy angers Whitehall" *The Guardian*, November 3, 1998.

⁵ R. Goode, *Principles of Corporate Insolvency Law* (2nd ed. 1997, Sweet and Maxwell, London), p. 141; J. Farrar, N. Furey, R. Hannigan and P. Wylie, *Farrar's Company Law* (3rd ed. 1991, Butterworths, London), p. 709; Report of the Insolvency Law Review Committee, *Insolvency Law And Practice*, Cmnd 8558 (1982) (the Cork Report) at para. 233; Finch, "Directors' Duties: Insolvency and the Unsecured Creditor" in *Current Issues in Insolvency Law* (A. Clarke ed. 1991 Stevens, London), p. 87; A. Keay, *Insolvency: Personal and Corporate Law and Practice* (3rd ed. 1998, John Libbey and Co., Sydney), pp. 15 and 440; McCoid, "Bankruptcy Preferences and Efficiency: An Expression of Doubt" (1981) 67 *Virginia Law Review* 249 at 260; Fortgang and King, "The 1978 Bankruptcy Code: Some Wrong Policy Decisions" (1981) 56 N.Y.U.L.R. 114 at 116.

⁶ See, e.g. *Audley v. Halsey* (1628) Cro. Car. 148; 79 E.R. 731; *Brassey v. Dawson* (1734) 2 Str. 978; 93 E.R. 980; *Stacey v. Halse* (1780) 2 Doug. 411; 99 E.R. 264.

⁷ Cd 3052 (1906) at para. 84.

⁸ Cmd 6659 (1943) at para. 153.

⁹ Cmnd 221 (1957) at paras 86-97.

¹⁰ Report of the Insolvency Law Review Committee, *Insolvency Law And Practice*, Cmnd 8558 (1982).

¹¹ In "Priority Rights on Corporate Insolvency" in *Current Issues in Insolvency Law* (A. Clarke ed. 1991,

the regime in 1986, there undoubtedly remains significant creditor discontent.¹² Mr Graham Mason, the business environment director of the Confederation of British Industry, has said, "Once the government and the banks have had their share there is often not much left for the other creditors."¹³

In its report considering the National Audit Office report on the Redundancy Payments Services,¹⁴ the House of Commons Public Accounts Committee¹⁵ provides some idea of the amount of preferential debt owed to the government. The Redundancy Payments Service (part of the Department Trade and Industry or DTI) administers payments out of the National Insurance Fund to, *inter alia*, employees of insolvent businesses. These payments are made under the Employment Rights Act 1996 and give employees more extensive protection than their preferential status under the Act. In making these payments the Crown is subrogated to the employees' rights under the Act, which include a preferential element. In the five years prior to the Audit Office report the Redundancy Payments Service paid out approximately £240 million each year to employees of insolvent businesses, of which only £20 million each year was recovered. As at March 31, 1996, £177 million of preferential debt was owed by insolvent businesses to the DTI. In the five years up to April 5, 1996, insolvent businesses owed the Department of Social Security or DSS £596 million of preferential debt.

Somewhat surprisingly, neither H.M. Customs and Excise nor the Inland Revenue kept separate figures for preferential debt owed by insolvent businesses. The Inland Revenue estimated that it was owed between £100 and £150 million of preferential debt as at October 31, 1995. H.M. Customs and Excise had written off £198 million of preferential debt in the year ending December 31, 1995.

Following the National Audit Office report, the DTI and H.M. Customs and Excise have been pursuing their preferential claims more aggressively. The Public Accounts Committee recommended that the Inland Revenue and the DSS should follow their lead. The various government departments have set up a joint working group to co-ordinate their attempts to recover more preferential debt.

This is the backdrop to the Secretary of State's announcement. Its timing is somewhat ironic. Just as government departments are beginning to chase their respective entitlements to preferential debts with new found tenacity, the government is considering abolishing their preferential status. Three years ago, abolition would have had an impact on government coffers. Its impact now would be considerably more dramatic.

Mr Mandelson's comments cause one to wonder whether the regime should be maintained in any shape or form. The arguments in favour of and against the existence of preferential debts have been well documented in legal literature over the past 20 years or so,¹⁶ but it seems from our investigations that there has been no analysis of the question based on empirical data. This is not unusual: insolvency issues have rarely been examined in light of such data,¹⁷ and several

Stevens, London), p. 74 and n. 34, Professor Milman records that the government only agreed to relinquish certain preferential rights while the Insolvency Bill was making its way through Parliament.

¹² Goode, "The Death of Insolvency Law" (1980) 1 Co. Law 123 at 127; Ziegel, "Preferences and Priorities in Insolvency Law: Is There a Solution?" (1995) 39 *Saint Louis Law Journal* 793. The disillusionment of creditors is mentioned in Justice, *Insolvency Law: An Agenda for Reform* (1994, London), pp. 22-23.

¹³ Wighton, "Tax bodies may lose their preferential creditor status", *Financial Times*, November 3, 1998.

¹⁴ H.C. 695 Session 1995/96, "Redundancy Payments Service: Management and Recovery of Debt".

¹⁵ H.C. 1998 Eighteenth Report, "The Department of Trade and Industry Redundancy Payments Service: The Management and Recovery of Debt".

¹⁶ For example, see Shanker, "The Worthier Creditors (and a cheer for the King)" (1975-76) 1 *Canadian Business Law Journal* 341; Arner, "The Worthier Creditors (And a Cheer for the King)—Revisited" (1979) 53 *Am. Bank. L.J.* 389; Gleig, "Unpaid Wages in Bankruptcy" (1987) 21 *University of British Columbia Law Review* 61; Cantlie, "Preferred Priority in Bankruptcy" in J. Ziegel, *Current Developments in International and Comparative Corporate Insolvency Law* (1994, Clarendon Press, Oxford); Symes, "The Protection of Wages when Insolvency Strikes" (1997) 5 *Insolvency Law Journal* 196.

¹⁷ An exception is the excellent study undertaken by Professor David Milman and Dr Rebecca Parry (and commissioned by the Insolvency Lawyers' Association) in relation to avoidance provisions. See "A Study of the Operation of Transactional Avoidance Mechanisms in Corporate

normative approaches to the law of insolvency have been developed by commentators without considering any empirical data whatsoever.¹⁸

It is both timely, given Mr Mandelson's comments, and appropriate, that empirical data should be examined as to whether the preferential debts regime ("the regime") contained in the Act should be retained. In mid-1998 we sent a questionnaire to 225 licensed insolvency practitioners in which they were asked several questions concerning the regime. We received 77 responses—a good response rate of a little over 34 per cent. This article discusses the regime in the light of those responses in an attempt to arrive at some view as to whether the regime should be reformed or even abolished.

The Empirical Data

General Issues

An analysis of the legal position as far as the regime is concerned only takes us so far. It does not tell us what is actually happening in practice; only an empirical study can do that. Determining what empirical data should be obtained is not an easy task. It is probably correct to say that technically the only way of deciding empirically whether the regime should be abolished or not would be to collect data during the course of two time periods, one in which the regime operates and one where it does not, then compare the results. For obvious reasons this is not practical. We decided that the best course of action was to prepare and send a questionnaire addressing issues pertinent to the regime and how it impacts on relevant aspects of insolvency law to the persons who would have most information concerning the operation of the regime in practice, licensed insolvency practitioners. While some solicitors who are licensed insolvency practitioners were sent questionnaires the majority were sent to accountants, who handle the vast bulk of liquidations and, in general, have greater experience when it comes to the administration of estates and the distribution of assets. The questionnaires were sent to practitioners in England and Wales. We would like to thank the practitioners who took the time to complete the questionnaire.

In order to secure as many responses as possible, we kept the questionnaire relatively short. It was divided into three parts. Section A sought responses in order to gauge whether respondents felt that the regime precipitated problems: are its effects positive, neutral or negative in relation to certain specific issues, namely, creditor attitudes, the administration of estates, rescues and the initiation of winding up proceedings? Section B sought estimates from practitioners regarding the general fate of funds payable by liquidators to creditors. Section C canvassed the views of practitioners, in light of their experience, on the abolition or alteration of the rights of preferential creditors. In the following discussion we have rounded percentages to the nearest whole number.

Section A

In this section we gave the practitioners a number of statements and asked them to respond. There were five options: strongly disagree, disagree, no view, agree or strongly agree.

In response to the statement, "The current regime for the payment of preferential debts precipitates unsecured creditor discontent," 68 per cent of our respondents either agreed or strongly agreed. Ten per cent of respondents did not have a view and 22 per cent disagreed with the statement. Of those who disagreed, only four per cent disagreed strongly.

The second question asked practitioners whether the resolution and payment of preferential debts prolonged the winding up process. Fifty per cent of the respondents felt that it did. Eleven per cent had no view on the matter, and 39 per cent felt that the process was not prolonged.

The third question asked whether the resolution and payment of preferential debts increased the costs of winding up. In response, 47 per cent of the practitioners were of the opinion that it did, 15 per cent had no view and 38 per cent thought that it did not increase costs.

Insolvency Practice" (1998, GTI Specialist Publishers).

¹⁸ In the U.S. this can be seen in both Professor Jackson's creditors' bargain theory ("Bankruptcy, Nonbankruptcy Entitlements and the Creditors' Bargain" (1982) 91 Yale L.J. 857) and Professor Korobkin's bankruptcy choice model ("Contractarianism and the Normative Foundations of Bankruptcy Law" (1993) 71 Texas L. Rev. 541).

In the light of the emphasis now laudably placed on rescuing viable business undertakings, respondents were asked to comment on what effect, if any, the Crown's priority had on proposed corporate rescue packages. Seventy-eight per cent of respondents said that the priority enjoyed by the Crown diminished the possibility of rescue. Three per cent had no view, and 19 per cent felt that the priority did not affect the prospects of a rescue.¹⁹

Further on the question of corporate rescues we asked practitioners to comment on whether the Crown seemed to have a general policy of voting against rescue packages. Sixty-two per cent took the view that it did. Eleven per cent expressed no view and 27 per cent said that it did not. In the same vein, we asked if practitioners thought that the Crown would become more amenable to agreeing to rescue packages if its preferential status was abolished. Fifty-one per cent said yes, 15 per cent had no view and 34 per cent said no.

Finally, we asked whether practitioners thought that having a priority made the Crown less likely to initiate winding up proceedings. Eighty-two per cent of respondents took the view that it did not. Twelve per cent had no view, and only six per cent felt that the priority made it less likely that the Crown would initiate liquidation proceedings.

Section B

It was thought important and highly relevant to ascertain to what extent dividends paid to preferential creditors absorbed the company's assets; this would, *inter alia*, give some idea of the extent to which unsecured creditors were affected by the regime. Along the same lines we inquired as to how often dividends were paid to unsecured creditors and how the satisfaction of floating chargeholders, who had priority over unsecured creditors but not over preferential creditors,²⁰ affected dividends that would have been paid to unsecured creditors.

Only 65 respondents replied to the question "In what percentage of insolvent windings up have distributions to preferential creditors absorbed the company's assets?" Fifty-five per cent of respondents said that preferential creditors took the assets of companies in over 60 per cent of cases.

In response to the question, "In what percentage of insolvent liquidations has a dividend been paid to unsecured creditors?", 85 per cent of the 65 practitioners who responded said that it was in 30 per cent of cases or less.

Finally, respondents were asked, in relation to those insolvent windings up where there were floating charges, had the floating charges absorbed the company's assets? Sixty-one practitioners responded and the views given demonstrated no pattern. Twenty-nine per cent said 10 per cent or less. Ten per cent said that charges absorbed the assets in 21-30 per cent of cases, while another 10 per cent gave 41-50 per cent as their answer. At the other end of the spectrum, 13 per cent said that the answer was in the range of 71-80 per cent and 13 per cent took the view that this happened in 91-100 per cent of liquidations.

Section C

In this section of the questionnaire, practitioners were asked a preliminary question: would you abolish preferential debts? The answer to this question determined whether the respondent needed to answer the rest of the questions in the section. Forty-six per cent of respondents said that they would abolish preferences, and were not asked to answer any further questions. Fifty-four per cent of respondents answered the remaining questions, which are discussed in this section of the article.

The first question asked practitioners whether they felt that the Crown's preferential status should be abolished. Thirty-two per cent said yes. In answer to the second question, whether the Crown's priority should be extended in any way, only one practitioner said that it should. All of this means that 62 per cent of all respondents thought that the Crown's preferential status ought to be abolished.

As far as the preferential status of employees was concerned, 95 per cent of respondents said that they would not abolish the priority enjoyed by employees, although only 43 per cent said that they would extend the employees' preferential position.

From time to time, publicity and professional support have been given to the idea of²¹ instituting a new category of preferential creditor—the consumer debtor

¹⁹ It seems that the preferential status of the Crown is regarded in the business world as an inhibitor to the implementation of rescues: Wighton, "Tax bodies may lose preferential creditor status", *Financial Times*, November 3, 1998.

²⁰ See Insolvency Act 1986, s.175(2)(b).

²¹ Samuels, "Prepayments: The Lost Consumer Deposits" [1987] J.B.L. 30.

who has made prepayments for goods and/or services to companies which end up in insolvent liquidation. As Samuels has indicated, the examples of prepayments being made to companies which have not made prepayments to their suppliers and which enter liquidation are legion, with clothing, furniture, carpets, double-glazing and home improvements being particularly vulnerable.²² It has been argued that consumer creditors in this type of situation are not to be classified in the same way as other unsecured creditors, such as traders, because, *inter alia*, traders are aware of the risks, they can make inquiries, they make commercial judgments, they can use *Romalpa* clauses and they can offset losses against gains for tax purposes. Prepayment consumers are laypersons who are generally ignorant of the law and commercial practice and do not understand the risks involved.²³ We decided to broach this issue with our respondents. Sixty per cent said that they would not introduce a new preference category for prepayment consumer creditors.

Finally, when asked whether they would advocate the introduction of any other new class of preferential creditors, 97 per cent of the practitioners said that they would not.

Commentary

It is notable that, with corporate rescue generally regarded as a critical aim of insolvency law,²⁴ 78 per cent of our respondents took the view that the priority enjoyed by the Crown diminished the possibility of rescue. It could be said that the Crown, from a narrow financial point of view, has no need to see companies survive as it is likely to get paid in a winding up. Sixty-one per cent of our respondents said that the Crown seemed to have a general policy of voting against rescue packages. If its priority was abolished, the Crown would have to be more concerned about the fate of companies, and perhaps take on a more proactive role. This would surely be consistent with the aims which Peter Mandelson outlined in his recent speech to the Confederation of British Industry.

It was somewhat surprising that 82 per cent of respondents did not agree that the Crown's priority makes it less likely to initiate winding up proceedings.²⁵ It has frequently been argued²⁶ that because the Crown is assured of preferential rights it is not encouraged to take action to recover what it is owed or to initiate winding up proceedings to stop insolvent companies trading.²⁷ If this latter view is correct, it is likely that companies with an accumulated tax liability which continue to trade would run up further tax liabilities.²⁸ This may well be deleterious to ordinary creditors who extend further credit and who may not be aware of the tax liability.

The traditional argument that the revenue authorities do not initiate winding up proceedings as often as one would expect does seem to have a degree of creditability. While the Crown has the *ability* to monitor debtors it lacks, for a number of reasons, the appropriate incentives: government does not bear the cost of default itself—it is passed on to taxpayers. The people responsible for administering the Revenue's affairs have no stake in the recovery of debts owed to the government.²⁹

On the issue of abolishing employees' preferential status, our respondents were split almost exactly down the middle. This may be the fault of the question, which failed to differentiate between employees' preferential position under the Act and the more extensive protection afforded them under the Employment Rights Act 1996 (ERA) scheme funded by the National Insurance Fund. It is submitted that as long as employees of insolvent companies maintain their employment protection rights under the ERA they do not need overlapping protection under the Act. The preference under the Act serves only to give the Crown rights of subrogation to claw back some of the money expended under the ERA scheme.

Sixty-two per cent of the responses we received in relation to the distribution of dividends indicated that, in a clear majority of cases, preferential creditors take the assets of insolvent companies. Further, a large majority of practitioners said that unsecured creditors receive a dividend in less than 30 per cent of liquidations. This makes it easy to see why there is significant creditor discontent in the community.

With the preferential regime as it stands, and current levels of creditor discontent, creditors may well refrain from initiating winding up proceedings against an insolvent company where it is known that there are substantial

²² *ibid.*

²³ *ibid.* at 31.

²⁴ Cork Report at para. 198; Segal, "Rehabilitation and Approaches other than Formal Insolvency Procedures" in *Banks and Remedies* (R. Cranston ed. 1992, Lloyds of London Press, London), p. 131; Rajak, "The Challenges of Commercial Reorganizations in Insolvency: Empirical Evidence from England" in J. Ziegel, *Current Developments in International and Comparative Corporate Insolvency Law* (1994, Clarendon Press, Oxford), p. 191.

²⁵ Eleven per cent of the respondents had no view, and 7 per cent agreed that the Crown's priority makes it less likely to initiate winding up proceedings.

²⁶ For example, see Cantlie, "Preferred Priority in Bankruptcy" in J. Ziegel, *Current Developments in International and Comparative Corporate Insolvency Law* (1994, Clarendon Press, Oxford), p. 438. In Australia the Australian Law Reform Commissions' General Insolvency Inquiry ("the Harmer Report") accepted the fact that the Crown's right to a preference means that it is not under any pressure to take action to recover its debts through winding up or other proceedings (at paras 735 and 737). Also see Garrido, "The Distributional Question in Insolvency: Comparative Aspects" (1995) 4 *International Insolvency Review* 25 at 47.

²⁷ See the recommendations made by the Comptroller and Auditor General in "Redundancy Payments Service: Management and Recovery of Debt", H.C. 695 Session 1995/96.

²⁸ See the comments of Hoffmann J. (as he then was) in *Re R. A. Foulds Ltd* (1986) 2 B.C.C. 99,269 at 99,274.

²⁹ Cantlie, "Preferred Priority in Bankruptcy" in J. Ziegel, *Current Developments in International and Comparative Corporate Insolvency Law* (1994, Clarendon Press, Oxford), p. 438.

amounts owed to the Crown. Creditors would not proceed on the grounds that they were unlikely to see any of what was owed to them. If creditors commence winding up proceedings and succeed in obtaining an order, they may well recover the taxed costs of obtaining the order, but they would be liable to pay their solicitors and counsel more than is likely to be awarded to them on a taxation. Undertaking the proceedings would be a waste of time. There is a public policy issue here. If creditors do not initiate proceedings there is nothing to stop a hopelessly insolvent company obtaining more and more credit from people who are unaware of its predicament, with no hope of repaying what is borrowed. Ultimately, it is the creditors who will lose out.

Besides the fact that the abolition of the regime would prevent the unfairness which exists where some unsecured creditors get paid and others do not, the responses we received indicated that there would be other benefits of abolishing preferential treatment. First, it is likely that abolition would save costs and lead to more speedy windings up.³⁰ Secondly, there would be more chance of rescuing a company.³¹ Thirdly, more funds would be paid to the unsecured creditors.³²

A likely further benefit would be that banks would not spend the time and money which they presently do seeking ways of circumventing the effects of the regime. At the moment, preferential creditors are entitled to be paid before a creditor who holds a floating charge over company assets.³³ Banks and other lenders have sought ways of ensuring that their security is subject to fixed charges, because the holders of such charges are not subject to the preferential creditors' regime.³⁴

It is acknowledged that abolishing preferential debts would benefit the holders of floating charges, as there would no longer be any class of debt with priority over such creditors. This is an unintended benefit which unsecured creditors can do nothing about. This article does not purport to comment on the rights of floating charge holders, which is a separate question. But if the regime was abolished the fact is that unsecured creditors would receive more than they do at present. As indicated above, under the present regime lenders continue to expend enormous resources on attempting to draft and then enforce fixed charges over changing assets. The difference between fixed and floating charges remains at best uncertain.³⁵ If the preferential debts regime was abolished, the distinction between a fixed and a floating charge would become less crucial to lenders, whose position would generally be much more secure. The struggle to find a fixed charge over changing assets would lose much of its practical significance.

Should the government decide to abolish preferential debts, it may also wish to reconsider the Cork Committee's recommendation³⁶ for a 10 per cent fund to be set aside for the benefit of unsecured creditors. In a letter to *Insolvency Practitioner*,³⁷ Mr Gerry Weiss, the former Technical Director of the Society of Practitioners of Insolvency, strongly advocates the resurrection of this recommendation. Mr Weiss believes that, although the 10 per cent fund would reduce the money available to secured lenders, the impact of this on lenders would be eased by a *quid pro quo* in the form of the abolition of preferential debts: what the banks lose on the swings, they gain on the roundabouts. The 10 per cent fund could lead to a dividend for unsecured creditors where before there would have been none at all. In addition, the fund could be used by the liquidator as a kind of "fighting fund" to investigate the company's failure in more detail and to help fund litigation to swell the company's assets.³⁸ According to Professor Milman's editorial comment in an earlier issue of this journal,³⁹ with which we respectfully agree, this is part of "the most fundamental issue in insolvency law and it is one where least progress has been made in recent years. There must be action here if our system of insolvency law is to regain public respect."

Conclusion

From an empirical study of the preferential debts regime it would seem that the regime needs to be reformed. We would argue that this accords with sound arguments calling for the abolition of the regime and the fact that historically the regime has not developed pursuant to any policy reasons, or certainly not on any policy basis that can be defended. We would submit respectfully that Peter Mandelson was on the right track in considering the abolition of the Crown's right to

³⁰ The response to the question concerning the effect of the regime on the winding up process which attracted the most support was that the regime did prolong the process (50 per cent). Again, the response which attracted the most support in relation to whether the regime increased costs was that it did (47 per cent).

³¹ Seventy-eight per cent of all respondents to our questionnaire felt that the Crown priority reduced the possibility of a rescue package being implemented.

³² For example, a clear majority of respondents (62 per cent) said that preferential creditors absorbed the funds available for distribution.

³³ Insolvency Act 1986, s.175(2)(b).

³⁴ *Re Lewis Merthyr Consolidated Collieries Ltd* [1929] 1 Ch. 489; *Re G. L. Saunders Ltd* [1986] 1 W.L.R. 215.

³⁵ See Gregory and Walton, "Fixed Charges Over Changing Assets—The Possession and Control Heresy" [1998] Cfi.L.R. 68 and by the same authors, "Book Debt Charges—The Saga Goes On" (1999) 115 L.Q.R. 14.

³⁶ Para. 1538.

³⁷ August 1998, p. 32.

³⁸ For a discussion of the problems facing liquidators in funding litigation, see generally Milman and Parry, "A Study of the Operation of Transactional Avoidance Mechanisms in Corporate Insolvency Practice" (1998, GTI Specialist Publishers) and Parry, "Funding Litigation in Insolvency (*Re Oasis Merchandising; Katz v. McNally*)" [1998] Cfi.L.R. 121.

³⁹ [1999] *Insolvency Lawyer* 1.

priority in an insolvent winding up. Clearly, the majority of the practitioners who responded to our questionnaire believe that the time is right for the abolition of the Crown priority. The claims of tax authorities have tended historically to be given priority in most legal systems, but in recent years there has been a trend towards either abolition or a reduction in the advantages granted. For instance, while countries such as France, Spain, Ireland and Italy retain wide preferential rights for tax liability, other countries such as Denmark, Sweden, Finland, Austria, Germany, Portugal and Australia have all abolished any priority status for the revenue authorities in recent years.

As long as the ERA scheme remains in place, there seems no reason—other than in order to maintain the Crown’s subrogation rights—why employees should not also lose their preferential position under the Act. This would have the consequence of relegating the Crown’s subrogation rights to those of an unsecured creditor.⁴⁰

Total abolition of the regime would certainly be favoured by the many unsecured creditors who regularly lose out in insolvent liquidations and who are clearly disillusioned by the winding up process: 68 per cent of respondents agreed that the present regime causes creditor discontent. The Cork Committee took the same view when it said that:

“We are left in little doubt that the elaborate system of priorities accorded by the present law is the cause of much public dissatisfaction, and that there is a widespread demand for a significant reduction, and even a complete elimination, of the categories of debts which accorded priority in an insolvency.”⁴¹

It is submitted that if abolition occurred and there was true equal treatment of creditors, there would be more chance of more creditors of insolvents surviving the collapse of debtors. At present many creditors, as a result of the liquidation of their debtors, either struggle financially or themselves enter liquidation or bankruptcy. The equality principle obviously means that the impact of liquidation will be spread among all classes of creditors,⁴² and there is a greater likelihood of more creditors continuing to trade.⁴³ This is particularly so for less powerful creditors, who may not have the option of using influence and threats to extract the payment of their debts prior to winding up.

⁴⁰ As was recommended by the Cork Committee, para. 1435.

⁴¹ Para. 1397.

⁴² See the comments of Millett J. (as he then was) in *Re Barlow Clowes Gilt Managers Ltd* [1991] B.C.L.C. 750 at 760.

⁴³ Of course, there will be liquidations where no dividend whatsoever is paid to creditors. However, where the equality principle exists, a creditor is more likely to receive something where there are assets to be distributed.

THE PREFERENTIAL DEBTS REGIME IN LIQUIDATION LAW : IN THE PUBLIC INTEREST?

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For many years certain creditors of companies in insolvent liquidations have been entitled to preferential treatment when it comes to the payment of dividends by liquidators. This article examines the rights of preferential creditors historically, legally and empirically and comes to the conclusion, inter alia, that these rights have not been developed pursuant to any considered policy and that it is unfair that unsecured creditors often lose out on any benefit in a liquidation because of the existence of preferential rights. The government has recently acknowledged the need to reconsider the Crown's preferential status. This article submits that it is timely to abolish all preferential rights.

A. INTRODUCTION

When liquidators come to the point of distributing the property of the companies whose affairs they are winding up, they are not able simply to distribute the property equally among the creditors who have proved their debts. Before consideration is given to making any payment in favour of the unsecured creditors, the proceeds from the realisation of any property which constitutes a creditor's security will be paid to the secured creditor to the extent of the secured creditor's debt against the company¹ and the expenses of the liquidation will be satisfied out of the general funds received by the liquidator.² Even once these payments have been made the fact is that in most liquidations the unsecured creditors will still not share in the funds remaining.³ The reason is that before they get paid anything the liquidator is required to pay out certain unsecured creditors who, while having no priority under the general law, are given by the Insolvency Act 1986⁴ a special priority to payment. These creditors are often known as "preferential creditors" and the amount which they are owed can often be so large that there is nothing left for the gen-

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¹ The holders of floating charges will have their right to payment postponed until the payment of both the expenses of the liquidation and the preferential creditors referred to in the Insolvency Act 1986, s 175(2)(b) Sched 6.

² See the Insolvency Rules 1986, r 4.218.

³ The Business Environment director of the Confederation of British Industry, Mr Graham Mason has said, "Once the government and the banks have had their share there is often not much left for the other creditors": D Wighton, "Tax bodies may lose their preferential creditor status" *Financial Times*, 3 November 1998.

⁴ All references in this article to sections will, unless the contrary is indicated, be references to the Insolvency Act 1986.

eral unsecured creditors. This state of affairs has provoked unsecured creditors to feel frustrated and to complain that they are poorly dealt with by the insolvency system.⁵ Such discontent has meant that there is a constant debate as to whether there should be any preferential creditors and, if so, who should qualify.⁶

The obvious problem faced by a legislature is that with an insolvent company not every creditor can be satisfied in full. Consequently the law has to decide which creditors are paid in full and the extent to which others are paid, if at all. The law seeks to find a proper balance between the claims of persons affected by the insolvency and to do this on the basis of public policy,⁷ for there is no doubt that issues of public policy have influenced and will continue to influence the debates in relation to the resolution of problems precipitated by the insolvency of companies (and individuals). The real question is what system carries out best that which is in the public interest. Is it in the public interest to ensure that debts owed to the government, as a representative of the public, are paid in priority to ordinary unsecured creditors? Is a system which balances the government's claims even-handedly with those of ordinary unsecured creditors one which, in the words of Lord Eldon, gives effect to the "preponderance of good".⁸

The regime which provides for preferential debts in England is found in a combination of s 386 and Schedule 6 of the Act. The same regime applies also to bankruptcies but this article limits itself to a consideration of the regime as it affects liquidations.

The article examines the situation which currently exists in England as far as preferential creditors are concerned. In the first part we trace the historical roots of the priorities given to certain classes of creditors in England. Second, we consider the present regime for the preferring of those creditors. Third, the article examines briefly the granting of preferential treatment to certain creditors in light of the *pari passu* principle, the foremost principle in the law of insolvency around the world. Fourth, we consider whether the present law is in need of reform and the shape any reform might take. The reform issue is discussed in light of an analysis of both the arguments which can be mounted for and against the granting of priorities and the empirical data which we collected.

We felt that the topic of this article warranted not only analysis based on historical, policy and legal considerations,⁹ but also analysis founded upon some empirical data. Consequently, we sent a questionnaire to 225 licensed insolvency practitioners in which they were asked several questions concerning the preferential debts' regime. We received 77 responses and those responses are discussed where appropriate.

⁵ RM Goode, "The Death of Insolvency Law" (1980) 1 Co Law 123, 127; J Ziegel, "Preferences and Priorities in Insolvency Law: Is There a Solution?" (1995) 39 Saint Louis L J 793. The disillusionment of creditors is mentioned in Justice, *Insolvency Law: An agenda for reform*, (London, 1994), 22-23. We sent out a questionnaire to a large number of licensed insolvency practitioners. Out of those responding, 68% were of the view that the preferential debts' regime precipitates discontent among unsecured creditors.

⁶ The Report of the Insolvency Law Review Committee, *Insolvency Law And Practice*, (Cmnd 8558, 1982) (hereafter "the Cork Report"), para 1398 was of the opinion that preferential treatment was only to be granted if it could be justified on the basis of fairness and equity. See the comment of J Garrido, "The Distributional Question in Insolvency: Comparative Aspects" (1995) 4 *International Insolvency Review* 25.

⁷ D Allan and U Drobnig, "Secured Credit in Commercial Insolvencies: A Comparative Analysis" (1980) 44 *Rabel's Zeitschrift* 615, 623. See also R Nimmer, "Negotiated Bankruptcy Reorganization Plans: Absolute Priority and New Value Contribution" (1987) Emory LJ 1009, 1024-1026.

⁸ *Re Wydown's Case* (1804) 14 Ves Jun 80, 88; 33 ER 451, 454.

⁹ For a discussion of comparative aspects of preferential debts, see Garrido, "The Distributional Question in Insolvency: Comparative Aspects" (1995) 4 *International Insolvency Review* 25.

B. HISTORICAL BACKGROUND¹⁰

Preferential debts have been recognised and developed in an entirely *ad hoc* manner for centuries and have only rarely been subject to serious consideration by any official body. The reports of the Warmington,¹¹ Cohen¹² and Blagden¹³ Committees suggested some minor amendments to the preferential debts regime. Only the Cork Committee of the DTI committees of the twentieth century looked at the issue in any depth. Since the Bankruptcy Act 1825, which for the first time introduced a preference in bankruptcy for certain employees,¹⁴ the history of preferential debts has not been a study in careful, methodical planning. Rather it has been a mixture of ancient rights being slowly whittled away and combined with occasional piecemeal additions.¹⁵

1. Crown debts

At common law the Crown's prerogative rights include the right to prevail over the unsecured debt of a subject, wherever their respective rights compete in a bankruptcy or winding up.¹⁶ This right to priority, like other prerogative rights, is subject to statutory abrogation, whereby the Crown may assent to restrictions being placed upon such a wide ranging preferential position.¹⁷ Until 1883¹⁸ the Crown was not expressly stated to be bound by the Bankruptcy Acts. The rule of statutory interpretation, that the Crown is not bound by any Act of Parliament unless it is named in it,¹⁹ effectively gave the Crown for centuries a priority over all other creditors in bankruptcy.

As a trustee (or assignee as they were formerly called) in bankruptcy takes possession of a bankrupt's assets as the bankrupt's representative, the trustee takes subject to equities. Statute apart, this formerly gave the Crown a kind of super priority in bankruptcy over other creditors as it had the right to be paid ahead of others. Once the bankrupt's property had passed under the Bankruptcy Acts by the appointment of assignees in bankruptcy, the property was deemed to be wholly changed, to have passed from the bankrupt

¹⁰ As the current preferential debts regime is essentially limited to a variety of Crown debts and claims of employees, this brief historical overview deals only with such debts. Local authority rates for example, introduced as a preferential debt into bankruptcy law by the Bankruptcy Act 1861, s 156 by way of analogy to the Crown's preferential position at the time (see *Hansard* 21 March 1861, 163) lost their priority position following the recommendations of the Cork Committee (see paras 1426 and 1427) and are not considered in this article.

¹¹ Cd 3052, (1906), para 84.

¹² Cmd 6659, (1943), para 153.

¹³ Cmnd 221, (1957), paras 86-97.

¹⁴ See the Bankruptcy Act 1825, ss 48 and 49.

¹⁵ For an early example of a statutory preference see the Friendly Societies Act 1793 (33 Geo 3 c 54).

¹⁶ See eg *Re Henley & Co* (1878) 9 Ch D 469; *New South Wales Taxation Commissioners v Palmer* [1907] AC 179; *Re HJ Webb & Co Ltd* [1922] 2 Ch 369.

¹⁷ The old forms of prerogative procedure were abolished by the Crown Proceedings Act 1947, s 26 of which limited the Crown's rights of execution to those of a subject. For a modern day discussion of the Crown's prerogative rights in liquidation, see *Herbert Berry Associates Ltd v IRC* [1977] 1 WLR 1437.

¹⁸ Bankruptcy Act 1883, s 150.

¹⁹ See eg *Maxwell on the Interpretation of Statutes*, 1st ed (Maxwell & Son, London, 1875), 112: "The Crown is not reached except by express words or by necessary implication in any case where it would be ousted of an existing prerogative."

and to be no longer subject to the Crown's process.²⁰ Before the appointment of the assignees, until the *cessio bonorum*, the property of the bankrupt was subject to the Crown's writ of extent.²¹ An ordinary creditor of the bankrupt was unable to claim the benefit of any execution over the bankrupt's assets after the act of bankruptcy, due to the doctrine of relation back²² which was introduced by the Bankruptcy Acts. As there was no statement in the Bankruptcy Acts binding the Crown, it could enforce its prerogative rights after the act of bankruptcy right up to the time of the assignment of the bankrupt's estate to the assignees.²³ An example of the Crown's prerogative rights is *Brassey v Dawson*²⁴ where a collector of land tax became bankrupt whilst holding outstanding amounts owing to the Crown. Seizure under a warrant (rather than a writ of extent) of the bankrupt's goods by the land tax commissioners was held valid against the assignees in bankruptcy because of the Crown's prerogative. The seizure occurred after the bankruptcy had commenced but before assignment of the bankrupt's property. Such rights of the Crown were exercisable against any debtor of the Crown. The debt did not have to relate to any particular type of debt.²⁵

The Crown's priority over general unsecured creditors was first put on a statutory footing by the Bankruptcy Act 1849. Section 166 provided that the court was to order payment of "assessed duties" but the Crown's rights were for the first time limited to 12 months' unpaid assessed taxes. Other debts and taxes owed to the Crown by implication lost their preferred status by this provision. The statutory priority for taxes was reworded under the Bankruptcy Act 1869, s 32 to include "assessed taxes, land tax, and property or income tax" but was still limited to one year's arrears. This provision was again replicated by the Bankruptcy Act 1883, s 40.

Section 150 of the 1883 Act also contained a provision for the first time expressly binding the Crown.²⁶ This at first sight may seem to be an unnecessary and rather tardy clarifying position. It appears to have been assumed that the Crown had, by assenting to s166

²⁰ See *R v Cotton* (1751) 2 Ves 295; 28 ER 186.

²¹ See *Audley v Halsey* (1628) Cro Car 148; 79 ER 731; *R v Pixley* (1725) Bunb 202; 145 ER 647; *R v Bewdley* (1712) 1 PWms 207; 24 ER 357; *Lechmere v Thorowgood* (1689) Comb 123; 90 ER 381; *Rorke v Dayrell* (1791) 4 TR 402; 100 ER 1087.

²² See eg the Bankruptcy Act 1914, s 37 which had the effect of relating back, the title of the trustee in bankruptcy to the bankrupt's property, to the act of bankruptcy relied upon for the adjudication order. The doctrine of relation back can be traced back to the Bankruptcy Act 1571 (13 Eliz 1, c 7).

²³ It became common in practice to ask the court for an order of provisional assignment immediately after the bankruptcy order. This was designed to prevent the Crown from exercising its powers to seize the bankrupt's estate and in so doing frustrating the claims of the Crown's subjects; see generally E Christian, *Present Practice in the Law of Bankrupts*, 2nd ed (1818).

²⁴ (1734) 2 Str 978; 93 ER 980.

²⁵ Independently of its prerogative rights, the Crown also enjoyed further specific rights under the various Excise Acts, which, as well as imposing duties on certain items, usually also gave the Crown a lien over the subject matter of the duty and the equipment used to produce it. In *Stacey v Hulse* (1780) 2 Doug 411; 99 ER 264, a candlemaker became bankrupt and was later convicted for non payment of single duty on candles he had made. Under the Statute of 8 Anne c 9, s 19, the candlemaker became liable to pay double duties and the Crown was given a right to distrain the candles, utensils and other materials in the hands of the assignee in order to satisfy the outstanding sum. See also *Attorney-General v Senior* (1739) 2 Doug 416; 99 ER 267, a case involving unpaid malt duties, and *Re Day* (1824) 1 M'Cle 384; 148 ER 160, which involved unpaid stagecoach duties.

²⁶ S 150 states: "Save as herein provided the provisions of this Act relating to the remedies against the property of a debtor, the priorities of debts, the effect of a composition or scheme of arrangement, and the effect of a discharge, shall bind the Crown".

of the 1849 Act, already agreed to its priority position's being limited.²⁷ The perceived need for absolute clarity may be due to the confusion which followed Parliament's attempt to introduce a regime for preferential creditors into company insolvencies.

The position of the Crown in the winding up of a company remained unaffected by the bankruptcy statutes. The Companies Act 1862 provided that, once a company entered liquidation, proceedings against the company were prohibited without leave of the court, any distress or execution against the company's assets would be void and the property of the company would be distributed to its creditors *pari passu*.²⁸ No mention was made in the Act of the Crown's rights and so the Crown was not bound by these restrictions.

The next development was for Parliament to act to assimilate the position of preferential creditors under bankruptcy and winding up. The Judicature Act 1875, s 10 provided that "the same rules shall prevail and be observed as to the respective rights of secured and unsecured creditors" in windings up of companies as existed for bankruptcy of individuals.

At first sight this provision appears to incorporate by reference the preferential debt regime of the Bankruptcy Act 1869 into the winding up of companies. This was not the view of the Court of Appeal in *Re Henley & Co.*²⁹ In an action brought by the Crown for unpaid property and income tax, the Court appeared to proceed entirely upon the Companies Act provisions and did not consider the Judicature Act 1875, s 10 to have introduced bankruptcy priority provisions into company liquidations. The result was that, because the Crown was not mentioned in the Companies Act, it was not bound by it and therefore had a right to be paid in full for the debt owed to it. This right survived even the liquidator's taking office, as in winding up there is no equivalent to bankruptcy's *cessio bonorum*. The company's property is not vested in the liquidator and so the Crown's rights to enforce its prerogative rights are not affected. The *Henley* decision was subsequently approved of by the Irish Court of Appeal³⁰ and the Privy Council.³¹ It also received tacit support from Parliament itself in that the Companies Act 1883, s 4 expressly introduced some of the Bankruptcy Acts' preferential creditors to liquidations. This would have been unnecessary if they had already been introduced by s 10.

The Preferential Payments in Bankruptcy Act 1888 listed together the categories of preferential debts for both bankruptcy and liquidations. Section 1(1)(a) included "... all assessed taxes, land tax, property and income tax assessed on the bankrupt or the company . . . not exceeding in the whole one year's assessment". The Act does not expressly state that the Crown is bound by it. The intention of this Act seems quite clearly to be to apply the same rules to preferential debts in liquidation as in bankruptcy. This is not how it was viewed. The practice in bankruptcy continued as before, that is, under the assumption that the Act gave priority to certain Crown debts but abrogated the Crown's priority

²⁷ See eg CJB Hertslet, *The Bankrupt Law Consolidation Act 1849* (John Crockford, London, 1852), 85; AA Doria, *The Law and Practice of Bankruptcy* (Horace Cox, London, 1874), 662; E Baldwin, *The Law of Bankruptcy*, 1st ed (Stevens and Haynes, London, 1879), 150. Although the trustee's title was held not to relate back as against the Crown, see *Ex p Postmaster-General* (1879) 9 Ch D 595. Section 150 of the 1883 Act made the Crown subject to the doctrine of relation back.

²⁸ Ss 87, 163 and 133 respectively.

²⁹ (1878) 9 Ch D 469.

³⁰ *Re Galvin* [1897] 1 IR 520.

³¹ *New South Wales Taxation Commissioners v Palmer* [1907] AC 179.

in respect of its other debts.³² In liquidations the decision in *Henley* continued in force. It was widely accepted that all Crown debts had a priority in winding up even after the Companies (Consolidation) Act 1908 (which in ss 186, 207 and 209 consolidated respectively the provisions of the Companies Act 1862, s 133 the Judicature Act 1875, s 10 and the Preferential Payments in Bankruptcy Act 1888, s 1). There was still no corresponding provision to the Bankruptcy Act 1883, s 150 expressly binding the Crown. Surprisingly, the belief that the Crown retained its universal priority over other creditors in winding up seems to have been unanimous.³³ The debate in the House of Commons on the Preferential Payments in Bankruptcy Act 1897, which made floating charges subject to preferential creditors, proceeded solely on the grounds that the Act would benefit employees of companies in receivership and liquidation. No mention was made of the Crown benefiting from the Act.³⁴

It was not until 1922 and the Court of Appeal's decision in *Re HJ Webb & Co Ltd*,³⁵ that it was finally decided that the Crown was bound by the preferential debt framework set out in statute. In this case the company had been appointed by the Board of Trade's Food Controller as its agent on a commission basis to sell and distribute frozen rabbits imported from Australia. The company collected purchase money on behalf of the Food Controller. The company entered insolvent liquidation owing money to the Food Controller. The issue before the Court was whether this Crown debt was entitled to priority of payment (as it would if the *Henley* decision was binding) or whether the debt merely ranked *pari passu* with other unsecured creditors. The Court of Appeal decided that at the latest the 1888 Act had superseded the Crown's prerogative rights to be paid in priority to other creditors and that remained the position under the 1908 consolidation Act. The *Henley* case was decided purely on the Companies Act 1862 and the Court of Appeal in that case "did ignore entirely the existence"³⁶ of the Judicature Act 1875, s 10. *Webb* finally settled that the Crown's rights to priority in liquidation were limited to only those taxes specifically mentioned in the Companies Act. The Crown was not entitled to an exclusive preferential position but enjoyed only an associated priority along with wages, rates and the other debts listed in the statute. Finally the Crown's position in liquidation and its position in bankruptcy were identified as being virtually identical.

The basic provision of s 209 of the 1908 Act survived into the Companies Acts 1929³⁷ and 1948³⁸ with only minor modifications. Parliament gradually acted to redress the balance back in favour of the Crown by adding various Crown debts to the statutory list.³⁹

³² See eg GL Hardy *Law and Practice of Bankruptcy* (Effingham Wilson, London, 1914), 130.

³³ See eg *Lindley on Companies*, Vol 2, 6th ed (Sweet and Maxwell, London, 1902), 998; *Gore-Brown Handbook on Joint Stock Companies* 34th Ed (Jordan, London, 1919), 568; *Pulmer's Company Law*, 11th ed (Stevens & Sons, London, 1921), 429.

³⁴ See *Hansard* 10 February 1897, 70–87.

³⁵ [1922] 2 Ch 369; affd sub nom *Food Controller v Cork* [1923] AC 647.

³⁶ Ibid, 392, per Younger LJ.

³⁷ S 264.

³⁸ S 319.

³⁹ See eg the National Insurance Act 1911, s 110 (national insurance contributions—which predates the *Webb* decision); the Finance Act 1952, s 30(2) (PAYE deductions); the Finance Act 1972, s 41 (VAT); s 52(11) and Sch 7 paras 1 and 18 Finance Act 1972 (car tax); the Finance Act 1969, s 3(9), Sch 9, para 16 and Betting and Gaming Duties Act 1972, Sch 1 para 14, Sch 2, para 11 and Sch 3, para 16 (general betting duty, gaming licence duty, bingo duty and pool betting duty); the Development Land Tax Act 1976, s 42 (development land tax).

This process continued until the recommendations of the Cork Committee⁴⁰ were largely implemented in re-structuring the current system.

2. Employees

The Bankruptcy Act 1825, s 48 introduced a preference over other creditors for clerks and servants where their employer became bankrupt. The preference allowed the Bankruptcy Commissioners to order payment of up to six months' wages or salary without limit. According to Doria⁴¹ the origin of this preference lies in Parliament adopting the same scheme which at that time existed in Scotland.

The Bankruptcy Act 1849, by s 168, placed a limit of three months not exceeding £30 upon the priority of servants and clerks, and introduced by s 169 a priority in favour of labourers and workmen subject to a maximum payment of 40 shillings but without any time limit. The Bankruptcy Act 1869, s 32 altered the priority of servants and clerks to a maximum of £50 for up to four months wages or salary, and labourers and workmen were limited to a claim for up to two months wages but with no maximum limit. As we have seen, the Court of Appeal decided in *Henley* that these provisions were not introduced into corporate insolvencies by the Judicature Act 1875, s 10.

The Bankruptcy Act 1883, s 40 brought labourers and workmen into line with servants and clerks by providing for a preference in bankruptcy of up to four months wages up to a maximum of £50 for both groups of workers. The Companies Act 1883, s 1(1) somewhat strangely repeated the same preference for servants and clerks in liquidations of companies but labourers and workmen were limited to two months wages with no monetary limit. Section 1(1) Preferential Payments in Bankruptcy Act 1888 for the first time applied the same categories of preferential creditors in bankruptcy as for winding up. It maintained the position of servants and clerks at a maximum claim of £50 for up to four months work but limited the claims of labourers and workmen to a maximum of £25 for up to two months work.

The Preferential Payments in Bankruptcy Act 1897 was passed as a response to the decision in *Richards v Overseers of Kidderminster*⁴² and comments made by the House of Lords in *Saloman v Saloman & Co Ltd*.⁴³ The Act gave preferential creditors priority over floating charge holders in both liquidations and receiverships. It did not alter the details of the claims of workers. The Companies Act 1929 retained the same distinctive priorities for servants and clerks on the one hand and labourers and workmen on the other. The 1929 Act included provision for workers' claims to include pay earned partly or wholly by commission. The welter of case law which had been spawned by the need to distinguish between "servants and clerks" and "labourers and workmen"⁴⁴ was rendered redundant when the Companies Act 1948, s 319⁴⁵ made the period four months and the maximum

⁴⁰ See paras 1409-1425

⁴¹ AA Doria, *The Law and Practice in Bankruptcy* (Horace Cox, London, 1874), 664

⁴² [1896] 2 Ch 212.

⁴³ [1897] AC 22, 53 *per* Lord Macnaghten: "Everybody knows that when there is a winding-up debenture-holders generally step in and sweep off everything; and a great scandal it is."

⁴⁴ See *eg* *Re Beeton & Co Ltd* [1913] 2 Ch 279; *Re London Casino Ltd* (1942) 167 LT 66.

⁴⁵ Acting on the recommendation of the Cohen Committee, para 153.

sum £200 (later increased to £800)⁴⁶ for both groups of workers. This was the scheme in place when the Cork Committee reported and which remains the basic framework for the current system.

C. THE REGIME

Section 386 and Schedule 6 of the 1986 Act detail the present categories of preferential debts for both individual and corporate insolvencies. Following the Cork Committee's recommendations the Crown lost its general preference in respect of unpaid taxes. Its rights were reduced to include generally only those taxes where the debtor was in effect the tax collector on behalf of the Crown.⁴⁷

The Act contains the following preferential debts. (It should be noted that the "relevant date" is defined in s 387 and differs depending upon the circumstances. In limiting the discussion to liquidation the date will generally be the date of the winding up order (compulsory liquidation) or the date of the passing of the winding up resolution (voluntary liquidation)).

1. PAYE income tax deductions made from emoluments paid during the period of 12 months prior to the relevant date;⁴⁸
2. Unpaid VAT for the 6 months prior to the relevant date;⁴⁹
3. Unpaid car tax, general betting duty, bingo duty, certain pool betting duty, gaming licence duty which became due in the 12 months prior to the relevant date;⁵⁰
4. Unpaid social security contributions for the period of 12 months prior to the relevant date;⁵¹
5. Any sums in relation to occupational pension schemes;⁵²
6. Remuneration⁵³ of employees for up to four months prior to the relevant date subject currently to a maximum payment of £800;⁵⁴
7. Any amount of employees' holiday pay accrued in respect of any employment prior to the relevant date;⁵⁵
8. Any sum loaned and used for the specific purpose of paying employees' remuneration.⁵⁶

Since the Act came into effect the following Crown debts have been added to the list:

⁴⁶ £800 figure introduced by the Insolvency Act 1976, s 1(1) and (3), Sch 1, Part I and Part II, para 6.

⁴⁷ See Cork Committee, paras 1418–1425, although it should be noted that not all these recommendations were incorporated into the Act: eg para 1424 recommended a preference for only three months' PAYE income tax.

⁴⁸ Sch 6 paras 1 and 2.

⁴⁹ Sch 6 para 3.

⁵⁰ Sch 6 paras 4 and 5.

⁵¹ Sch 6 paras 6 and 7.

⁵² Sch 6 para 8.

⁵³ a term defined widely in Sch 6 para. 13.

⁵⁴ Sch 6 para 9; the £800 figure is fixed by the Insolvency Proceedings (Monetary Limits) Order 1986 (SI 1986 No 1996), art.4.

⁵⁵ Sch 6 para 10.

⁵⁶ Sch 6 para 11.

9. Levies on coal and steel production;⁵⁷
10. Beer duty which became due in the 6 months prior to the relevant date;⁵⁸
11. Lottery duty which became due in the 12 months prior to the relevant date;⁵⁹
12. Insurance premium tax referable to the 6 months prior to the relevant date;⁶⁰
13. Air passenger duty which became due in the 6 months prior to the relevant date;⁶¹
14. Landfill tax referable to the six months prior to the relevant date.⁶²

In addition to the above, a separate statutory scheme exists for the protection of employees whose employers are unable or unwilling to meet certain of their liabilities to their workers.

Where payments are made under this scheme to employees, by the Secretary of State out of the National Insurance Fund under the Employment Rights Act 1996, the Secretary of State is subrogated to the employees' preferential rights to the extent that the payments made are in respect of the insolvent employers' liabilities which have preferential status under the Act.

D. PREFERENTIAL CREDITORS AND THE PARI PASSU PRINCIPLE

The general rule, embodied in s 107 of the Act for voluntary liquidations and in the Insolvency Rules 1986, r 4.181(1) for compulsory liquidations, as far as the distribution of assets in a liquidation are concerned, is that the company's property is to be applied equally towards its liabilities. The principle of equality of division among creditors is one of the (if not the most) fundamental principles of the law of liquidation (and of insolvency in general)⁶³ and is at the very heart of the whole statutory scheme of winding up. One commentator has regarded the principle as the most universal of all insolvency principles.⁶⁴ The principle is an old equitable principle and is known as the *pari passu* principle.⁶⁵

The principle is very important in that it "marks off the rights of creditors in a winding up from their pre-liquidation entitlements."⁶⁶ Prior to the commencement of winding up creditors are able to avail themselves of self-help measures, with the swiftest gaining satisfaction at the expense of the not so swift, but once winding up begins such action can-

⁵⁷ Sch 6 para 15A; introduced by the Insolvency (ECSC Levy Debts) Regulations 1987 (SI 1987 No 2093).

⁵⁸ Sch 6 para 5A; introduced by the Finance Act 1991, Sch 2 para 22.

⁵⁹ Sch 6 para 5B; introduced by the Finance Act 1993, s 36(2).

⁶⁰ Sch 6 para 3A; introduced by the Finance Act 1994, Sch s 36(2)7 para 2.

⁶¹ Sch 6 para 5C; introduced by the Finance Act 1994, Sch 7 para 13(1).

⁶² Sch 6 para 3B; introduced by the Finance Act 1996, s 60 and Sch 5 para 12(1).

⁶³ R Goode, *Principles of Corporate Insolvency Law*, 2nd ed (Sweet and Maxwell, London, 1997), 141; J Farrar, N Furey, R Hannigan & P Wylie, *Farrar's Company Law* 3rd ed, (Butterworths, London, 1991), 709; Cork Report, para 233; V Finch, "Directors' Duties": Insolvency and the Unsecured Creditor" in A Clarke (ed), *Current Issues in Insolvency Law* (Stevens, London, 1991), 87; A Keay, *Insolvency: Personal and Corporate Law and Practice*, 3rd ed (John Libbey and Co, Sydney, 1998), 15 and 440; J McCoid, "Bankruptcy Preferences and Efficiency: An Expression of Doubt" (1981) 67 Virginia LR 249, 260; C Fortgang and L King, "The 1978 Bankruptcy Code: Some Wrong Policy Decisions" (1981) 56 NYULR 1148, 116.

⁶⁴ J Westbrook, "A Functional Analysis of Executory Contracts" (1989) 64 Minnesota LR 227, 252. Professor Goode sees *pari passu* distribution as one of two purposes of corporate insolvency law: "The Death of Insolvency Law" (1980) 1 Co Law 123.

⁶⁵ J Farrar, "Public Policy and the *Pari Passu* Principle" [1980] NZLJ 100.

⁶⁶ R Goode, *Principles of Corporate Insolvency Law*, 2nd ed (Sweet and Maxwell, London, 1997), 142.

not be taken. Liquidation ushers in an orderly satisfaction of the debts and claims of creditors based on the *pari passu* principle.

The principle of equality has been affirmed in recent days in the UK,⁶⁷ and may be traced back at least to the bankruptcy statute of 1542,⁶⁸ which stated, that:⁶⁹

"... for true satisfaction and payment of the said creditors : That is to say, to every of the said creditors, a Portion Rate and Rate alike, according to the Quantity of their Debts."

The principle found favour with Lord Mansfield in 1758 in the case of *Worsley v Demattos*,⁷⁰ where his Lordship indicated that an equal distribution of a bankrupt's assets amongst his or her creditors was one of two objects of the laws of bankruptcy.⁷¹

But, the *pari passu* principle is not absolute in that for policy reasons the legislature provides for exceptions.⁷² The legislature's provision for preferential debts is the most significant inroad into the principle⁷³ and means that the aim of obtaining an equal distribution is seldom achieved.⁷⁴ In fact the Cork Report said that the *pari passu* principle had been so greatly eroded that it remains only as a theoretical doctrine, having little application in practice.⁷⁵ Notwithstanding that, the Committee indicated that the *pari passu* principle was to be seen as paramount.⁷⁶

The fact of the matter is that in England unsecured creditors will usually bear the burden of the insolvency of a company as it is they who depend on the fullest extent of the application of the *pari passu* principle. As the legislature has provided for preferential creditors one must assume that it is government policy that the unsecured creditors should bear the burden of the liquidation of insolvent companies.

The existence of priorities is predicated on the belief of the legislature that certain persons warrant some form of protection, and should be insulated from the insolvent's financial failure. The Cork Report was of the opinion that creditors should not receive priority under statute unless there was general public acceptance of the fairness and equity of granting such priority.⁷⁷ An example of a clear policy decision to grant preferential status on the basis, *inter alia*, of fairness is that of employees, who it has been determined should not be out-of-pocket because their companies have gone into liquidation.

The underlying aim behind the use of the equality principle is to produce fairness,⁷⁸ so

⁶⁷ Report of the Insolvency Law Review Committee, *Insolvency Law and Practice*, Cmnd 8558 (1982) ("Cork Report"), para 1220.

⁶⁸ 34 & 35 Hen 8 c 4. Garrido, "The Distributional Question in Insolvency : Comparative Aspects" (1995) 4 *International Insolvency Review* 25, 29 briefly considers the origins of the principle in the middle ages in Italy.

⁶⁹ S 2.

⁷⁰ (1758) 1 Burr 467; 97 ER 407.

⁷¹ (1758) 1 Burr 467, 476; 97 ER 407, 412.

⁷² See R Goode, *Principles of Corporate Insolvency Law*, 2nd ed, 151.

⁷³ Justice, *Insolvency Law : An agenda for reform*, (London, 1994), 24.

⁷⁴ Cork Report, para 1396. The Australian Law Reform Commission, *General Insolvency Inquiry*, Report No 45, 1988 ("Harmer Report"), para 713 was of the same view. *Pari passu* is very much at the heart of the rationale for the avoidance of pre-liquidation transactions : see A Keay, *Avoidance Provisions in Insolvency Law* (LBC Information Services, Sydney, 1997), 40-49.

⁷⁵ Cork Report, para 233.

⁷⁶ *Ibid*, para 1072. Australia's Law Reform Commission Report on *General Insolvency* (the Harmer Report) in 1988 also affirmed the principle and said that, to the maximum extent possible, the principle should be maintained (para 713).

⁷⁷ Cork Report, para 1398.

⁷⁸ Harmer Report, para 629; J McCoid, "Bankruptcy, Preferences and Efficiency : An Expression of Doubt" (1981) 67 *Virginia LR* 247, 271; T Ward and J Shulman, "In Defence of the Bankruptcy Code : Radical Integration of the Preference Rules Affecting Commercial Financing" (1983) 61 *Washington ULQ* 1, 16.

that every creditor is treated in the same way. Another aim, linked to the need for fairness, is to minimise the inevitable social and economic costs associated with liquidation.⁷⁹ For instance, when a company goes into liquidation many businesses may be owed substantial sums. A liquidation, particularly of large companies,⁸⁰ can precipitate financial problems for many of the company's trading partners, and can lead to a chain of failed enterprises;⁸¹ this is the so-called "ripple effect". If equal treatment of creditors were not invoked there is a greater chance that more creditors would not be able to survive the collapse of a debtor. The equality principle obviously means that the impact of liquidation will be spread among all classes of creditors,⁸² and there is a greater likelihood of more creditors continuing to trade.⁸³ This is particularly so for the less powerful creditors, who might not be able to use influence and threats to extract the payment of their debts prior to winding up.

Before a creditor is entitled to claim a preferred position it must be demonstrated that deviation from the inveterate and equitable *pari passu* principle is warranted.

E. REFORM

Unquestionably the *pari passu* principle is nothing more, and has little relevance, other than to act as a convenient default principle. Despite this fact most commentators, courts and law commissions affirm its appropriateness and support its employment. It is fair to say that the impact of the preferential creditor regime on the general body of unsecured creditors was lessened somewhat by the amendment of the regime in the wake of the recommendations of the Cork Committee. The Cork Committee said that it had received a considerable volume of evidence on the subject of preferential debts, that most of it was critical of the law that existed at that time and "much of it deeply hostile to the retention of any system of preferential debts."⁸⁴ As a result of the Cork Committee's recommendations the legislature, somewhat reluctantly,⁸⁵ decided, in the Act, to abolish unpaid rates and unpaid tax as preferential debts as well as reducing the amount of VAT having preferential status.⁸⁶ At issue is whether the Cork Committee's recommendations went far enough.

⁷⁹ T Jackson and A Kronman, "Voidable Preferences and Protection of the Expectation Interest (1976) 60 Minnesota LR 971, 989.

⁸⁰ Notable is the collapse of building companies.

⁸¹ Jackson and Kronman, "Voidable Preferences and Protection of the Expectation Interest (1976) 60 Minnesota LR 971, 989. It would appear that smaller undertakings are less able to absorb losses caused by the insolvency of their creditors and they make up the bulk of traders in Britain: "In 1997 there were 3.7 million firms in Britain. 99% of them had fewer than 50 employees" (Mr P Mandelson, former Secretary for Trade and Industry, Speech to the Annual Conference of the Confederation of British Industry, 2 November 1998).

⁸² *Ibid.*

⁸³ Of course, there will be liquidations where no dividend whatsoever is paid to creditors. However, where the equality principle exists a creditor is more likely to receive something where there are assets to be distributed.

⁸⁴ Para 1397.

⁸⁵ Professor DL Milman records in "Priority Rights on Corporate Insolvency" in A Clarke (ed), *Current Issues in Insolvency Law*, (Stevens, London, 1991), 74 and n 34 that the government only agreed to relinquish certain preferential rights while the Insolvency Bill was making its way through Parliament.

⁸⁶ Note the cautionary words of Professor Milman *ibid*, 76, where the learned commentator wonders whether the legislature will be tempted to restore some claims and he points out that the government added unpaid EEC levies to Schedule 6 (Insolvency (ECSC Levy Debts) Regulations 1987 (SI 1987 No 2093)).

The main preferential debts⁸⁷ which remain are amounts owed to the Crown in relation to taxes for items such as unremitted deductions of income tax during the period of 12 months before the relevant date and amounts owed to the company's employees.

1. The legal arguments

(a) Crown debts

Over recent years there has been a lively debate as to whether debts owed to the state in the form of taxes ought to enjoy preferential status. There are a number of arguments which can be made in favour of eliminating any priority for tax claimants. They probably can be reduced to four, possibly five, arguments.

First, debts owed to the Crown are insignificant compared with total government expenditure and government can distribute its losses among many taxpayers, while the amount lost by an unsecured private creditor because of the preference shown to the revenue could be the difference between financial survival or failure.⁸⁸ In response to this it has been argued that national governments operate at deficits⁸⁹ and every loss of tax aggravates the plight of the nation.⁹⁰ Governments are always in need of money – there are always projects waiting for funds before they can be initiated. The simple fact is that governments will never have enough money. It is well accepted that there is a substantial wastage factor in the administration of the affairs of government and it seems unfair that this is allowed to occur while a creditor may not survive because the claims of the revenue have demolished his or her dividend. It has been argued further that the resources of government are irrelevant and it is not appropriate to use an argument based upon the “depth of a person's pocket”.⁹¹ But the riposte to that argument is twofold: the whole idea of *pari passu* distribution is to ensure parity of benefit, no matter what resources one has—if there were no *pari passu* distribution we would return to the “first come, first served” policy of mediaeval times, which saw those with the greatest resources and power taking the debtor's estate; and preference has been accorded to people like employees for some years because they can least afford to miss out on their wages.

Second, the Crown authorities have access to a lot of the important information about a debtor, as well as the resources to engage personnel to provide accurate risk assessment;⁹² and, if they permit a debtor to continue to trade, given the information which they have, then it seems unfair that the unsecured creditors will usually end up “picking up the tab.”

The third argument, and allied to the latter argument, is that, as the Crown is assured of preferential rights, it is generally said that it is not encouraged to take action to recover

⁸⁷ See Sched 6.

⁸⁸ Harmer Report, para 735. The Cork Committee said that “a bad debt owed to the State is likely to be insignificant in terms of total Government receipts; the loss of a similar sum by a private creditor may cause substantial hardship, and bring insolvencies in its train” (para 1410).

⁸⁹ Recently President Clinton declared that the United States was no longer running at a deficit.

⁹⁰ M Shanker, “The Worthier Creditors (and a cheer for the King)” (1975–76) 1 Can Bus LJ 341, 343.

⁹¹ *Ibid.*

⁹² S Cantlie, “Preferred Priority in Bankruptcy” in J Ziegel, *Current Developments in International and Comparative Corporate Insolvency Law*, (Clarendon Press, Oxford, 1994), 438.

what it is owed or to initiate winding up proceedings;⁹³ the accumulation of tax liability, which involves less risk to the Crown, could be deleterious to ordinary creditors who may not be aware of the tax liability. Interestingly, while the Harmer Committee in Australia accepted the fact that the Crown's right to a preference means that it is not under any pressure to take action to recover its debts through winding up or other proceedings,⁹⁴ 82% of the respondents to the questionnaire which we circulated did not agree that the Crown's priority makes it less likely to initiate winding up proceedings.⁹⁵ The Cork Committee noted that there was often criticism directed at the revenue for being heavy handed in pursuing the collection of tax debts, resulting in the collapse of businesses which could have "weathered the storm" had more time been granted.⁹⁶ Running counter to the view expressed by our respondents is the assertion of Cantlie in relation to the Canadian position, that while governments have the ability to monitor debtors they lack the appropriate incentives to monitor for a couple of reasons : government does not bear the cost of default itself – it is passed onto taxpayers; and the people who have the responsibility of administering the revenue's affairs have no stake in the recovery of debts owed to the government.⁹⁷

Fourth, if the preferential treatment of the Crown was to end, creditors would be willing to take more interest, and a greater part, in the administration of liquidations.⁹⁸ As it is, ordinary unsecured creditors see involving themselves in the administration of estates as "equivalent to volunteering as agents of the public treasury."⁹⁹

Finally, it has been argued that because the Crown's priority originates with the debts of the monarch being paid first, the right to priority is anachronistic and is not worthy of a place in western society.¹⁰⁰

There are two main arguments which have been articulated in favour of giving preferential treatment to revenue authorities.¹⁰¹ First, the revenue is an involuntary creditor;¹⁰² it is not, unlike trade and secured creditors, able to choose its debtors.¹⁰³ The Crown por-

⁹³ See the recommendations made by the Comptroller and Auditor General in the Department of Trade and Industry, "Redundancy Payments Service : Management and Recovery of Debt" HC 695 Session 1995/96.

⁹⁴ Harmer Report, paras 735 and 737. Garrido appears to adopt the same view : "The Distributional Question in Insolvency : Comparative Aspects" (1995) 4 *International Insolvency Review* 25, 47.

⁹⁵ 11% of the respondents had no view and 7% agreed that the Crown's priority makes it less likely to initiate winding up proceedings.

⁹⁶ Cork Report, para 1421. After saying that the Report acknowledged that there were many complaints that the revenue was too complacent in collecting debts. But the Committee was satisfied that the complaints were mistaken (at para 1422).

⁹⁷ Cantlie, "Preferred Priority in Bankruptcy" in J Ziegel, *Current Developments in International and Comparative Corporate Insolvency Law*, (Clarendon Press, Oxford, 1994), 438.

⁹⁸ *Report of the Study Committee on Bankruptcy and Insolvency Legislation*, Canada, (1970), para 3.2.076, n 46 and para 3.2.077; referred to by Shanker, "The Worthier Creditors (and a cheer for the King)" (1975-76) 1 *Can Bus LJ* 341, 343; Cork Report, para 1434.

⁹⁹ *Report of the Study Committee on Bankruptcy and Insolvency Legislation*, Canada, (1970), para 3.2.077.

¹⁰⁰ Shanker, "The Worthier Creditors (and a cheer for the King)" (1975-76) 1 *Can Bus LJ* 341, 343.

¹⁰¹ Only two arguments in favour of retention of the preference were put to the Cork Committee : para 1409.

¹⁰² M Arner, "The Worthier Creditors (And a Cheer for the King) – Revisited" (1979) 53 *Am Bank LJ* 389, 392.

¹⁰³ In director disqualification proceedings under the Company Directors Disqualification Act 1986, s 6, it was once thought that non-payment of preferential Crown debts was in itself evidence of unfitness. In *Re Stanford Services Ltd* (1987) 3 BCC 326, 334, Vinelott J suggests that it is evidence of unfitness partly because the Crown is an involuntary creditor and partly because no director should continue to allow the company to trade whilst insolvent using monies which ought to be paid over to the Crown. The judicial approach to Crown debts in this type of action has not always been consistent (see eg *Re Dawson Print Ltd* (1987) 3 BCC 322, 325,

trays itself in a noble and righteous light, yet it is not the only involuntary creditor. As the Cork Committee pointed out there are many suppliers of goods and services who are constrained to permit credit as it is part of the custom of the trade,¹⁰⁴ notably in the building industry. Furthermore there are people who have actions in tort and contract who are also involuntary creditors.¹⁰⁵ Such persons, for example, the victims of the negligence of the debtor, are owed money for no fault of their own. It is not unusual these days to see one person businesses, mainly in the building industry, where the person has little or no choice but to extend credit to the head contractor.

It has been argued that the government, unlike a private creditor, has no practical way of requiring a cash advance or security.¹⁰⁶ However, the same can be said about most creditors. Yes, the banks can demand security and the supplier of essential services may be able to get "money up front" but most creditors either do not know that they could consider taking such action or, more likely, it is just not practical for them to make such demands. If they were to demand security or a cash advance then it is more than likely that the customer will find someone else to do the job or supply the goods.

There are other aspects to the voluntary creditor argument which are often ignored. Referring to many of those people who line up as creditors as "voluntary creditors" is illusory. Today it is not unusual to see people who may have been employees in the past being required by their employer to become sub-contractors, as this frees the employer from the payment of certain amounts and allows the employer to put off the contractors as and when it is convenient. Such sub-contractors¹⁰⁷ may have little choice as to whether they work for the former employer. Also some contractors are so big in particular industries that if a supplier were not to supply the contractor then the supplier could not exist. Another consideration is that it is impossible practically and financially for most, if not all, small to medium sized creditors of a company to embark on any action to ascertain the creditworthiness of companies before they agree to supply goods or services. Goods and services usually have to be supplied promptly. The costs involved in screening companies would be out of proportion to what profit would be earned.

The second argument is that the debts owed to the government must be seen in a different light from those owed to trade creditors because the former are owed by the debtor to all of the community in which the debtor trades and resides rather than to one creditor.¹⁰⁸ The argument, as far as the priority for unremitted PAYE tax deductions and VAT payments are concerned, is that it would be unfair not to allow a preference because the debtor is acting as a tax collector and it would be inequitable if the deductions and payments increased the amount available to the unsecured creditors.¹⁰⁹ With respect, as far as unremitted tax deductions and VAT payments are concerned, it is submitted that the

per Hoffman J). The Court of Appeal has found it "very difficult" to treat non payment of Crown debts any differently from other debts (*Re Sevenoaks Stationers Ltd* [1990] BCC 765, 779, *per Dillon LJ*). The consensus of judicial opinion is that Crown debts in themselves are not deserving of any greater consideration than other debts. This approach echoes the sentiment in 1804, of Lord Eldon who considered it his duty "to hold an even hand between the Crown and the subject": *Re Wyldown's Case* (1804) 14 Ves 80, 87–88; 33 ER 451, 453–454.

¹⁰⁴ Cork Report para 1414.

¹⁰⁵ *Ibid.*

¹⁰⁶ Shanker, "The Worthier Creditors (and a cheer for the King)" (1975–76) 1 Can Bus LJ 341, 345.

¹⁰⁷ They are not entitled to any priority: *Re CW & AL Hughes Ltd* [1966] 1 WLR 1369.

¹⁰⁸ S Cantlie, "Preferred Priority in Bankruptcy", in J Ziegel, *Current Developments in International and Comparative Corporate Insolvency Law*, (Clarendon Press, Oxford, 1994), 439.

¹⁰⁹ Cork Report, para 1418.

loss sustained by the Crown is akin to a form of misappropriation and consequently it should only be entitled to the same as any other person who has lost out because of the misappropriation by an agent.¹¹⁰ Persons who lose out in such a way can only claim as unsecured creditors, having no priority rights.

The claims of tax authorities have tended historically to be given priority in most legal systems, but there has been a trend in recent years for either abolition or a reduction in the advantages granted. For instance, while countries such as France, Spain, Ireland and Italy retain wide preferential rights for tax liability, and can be seen at one end of the spectrum, other countries such as Denmark, Sweden, Finland, Austria, Germany, Portugal and Australia are at the other end of the spectrum as they have abolished any priority status for the revenue authorities. The United States, New Zealand and England are representative of countries which have reduced the level of preference. Consequently, since the reforms introduced in the Act, England cannot be seen, as it once was,¹¹¹ as a jurisdiction in which tax authorities are strongly favoured. However, there are still preferences available that are very attractive to the revenue and which anger some. Calls for total abolition are not hard to find.¹¹² It is appropriate to note that the former trade and industry secretary, Peter Mandelson, told the Confederation of British Industry at a recent conference that the government was considering the position of the Crown in insolvency law.¹¹³ However, it is probable that the government will face opposition from the Treasury.¹¹⁴

Surely, the burden must be on the Crown to demonstrate why it, compared with other deserving ordinary creditors, should be accorded preferential treatment. We submit that when evaluating the arguments for and against preferential status the Crown is unable to prove its case.¹¹⁵ In the words of the Brookings Institution in the United States the tax priority is "based upon dubious logic and indefensible social policy".¹¹⁶

This is supported somewhat by the fact that 62% of those who responded to our questionnaire were of the view that Crown priority ought to be abolished. Of note is the fact that while the Crown may lose out if its preference is abolished, a substantial proportion of the tax lost would be able to be recovered from the tax paid by unsecured creditors in relation to the dividends which they will be paid and a reduction in the amount of bad debts written off against profits.¹¹⁷

An option which the government could pursue if it decided to abolish Crown priority is that initiated in Australia when that country totally abolished the Crown's priority. In lieu of the priority which the Crown formerly had in relation to unremitted tax deductions, a new regime was introduced into the tax legislation whereby the Commissioner of Taxation is now able to make estimates of outstanding tax instalment deductions.¹¹⁸ In a nutshell, if the Commissioner of Taxation suspects that a company which is liable to remit deductions has failed to do so by the due date he may make a reasonable estimate of the

¹¹⁰ See the Harmer Report, para 735.

¹¹¹ See the views of Professor R Goode in "The Death of Insolvency Law" (1980) 1 Co Law 123.

¹¹² For example, the Confederation of Business and Industry: see Justice, *Insolvency Law: An agenda for reform* (London, 1994), 7.

¹¹³ D Wighton, "Tax bodies may lose preferential creditor status", *Financial Times*, 3 November 1998; Atkinson, "Soft line on bankruptcy angers Whitehall", *The Guardian*, 3 November 1998.

¹¹⁴ D Atkinson, "Soft line on bankruptcy angers Whitehall", *The Guardian*, 3 November 1998.

¹¹⁵ This was the conclusion reached by the Cork Committee, para 1413.

¹¹⁶ D Stanley and M Girth, *Bankruptcy: Problems, Process, Reform*, (The Brookings Institution, 1971).

¹¹⁷ Cork Report, para 1416.

¹¹⁸ See the Income Tax Assessment Act 1936 (Cth), Part VI, Division 9.

liability and include this in a notice sent to the company which is liable;¹¹⁹ there is no need to establish the actual amount deducted and not remitted. The sending of the notice containing the estimate creates a liability to pay the estimate.¹²⁰

On receipt of an estimate directors are required to cause their company to adopt one of four courses of action:

- remit the amounts due;
- enter into a payment agreement;
- initiate a voluntary administration (equivalent to administration under Part II of the Act); or
- initiate winding up.¹²¹

The directors may become liable personally for the unremitted deductions if one of these events does not occur.

(b) Employees

It is not infrequently said that employees rely upon their wages, and should be paid before a creditor who, if it does not receive any or all of what is owed by the company, will simply be required to endure a reduction in profits. Hence, the employee priority is to “ease the financial hardship caused to a relatively poor and defenceless section of the community by the insolvency of their employer”.¹²²

The arguments, in favour of employees enjoying some priority in the insolvency of the employer, have been recited by several writers.¹²³ An early discussion of the problems facing employees can be found in the House of Commons debate upon the Preferential Payments in Bankruptcy Act 1897.¹²⁴ The debate considered that employees, unlike other creditors, had no way of assessing the financial standing of their employers. Employees were deserving of some special treatment because their efforts increased the value of the total assets available to all the creditors. Also the effect of the insolvency of the employer was more keenly felt by an employee than by other creditors.

The employee has for a long time attracted the sympathy of the legislature. The employee is seen as being in a weak bargaining position compared with other creditors and investors. Employees, when negotiating the terms of their employment contract do not usually insist upon a provision to protect them should the employer become insolvent. The effect of an employer’s insolvency on the employee is likely to be more serious than the effect on other creditors. Wages are likely to be the only source of income for an employee whilst other creditors are likely to have other sources of income. These are some of the reasons why employees have been given preferential status under the Act.

¹¹⁹ *Ibid*, s 222AGB(1).

¹²⁰ *Ibid*, s 222AHA(1).

¹²¹ *Ibid*, s 222AOB.

¹²² Cork Report, para 1428.

¹²³ See particularly S Cantlie, “Preferred Priority in Bankruptcy” in J Ziegel, *Current Developments in International and Comparative Corporate Insolvency Law* (Clarendon Press, Oxford, 1994); B Gleig, “Unpaid Wages in Bankruptcy” (1987) 21 UBCLR 61; C Symes, “The Protection of Wages when Insolvency Strikes” (1997) 5 Insolvency LJ 196; D Zatzman, “The Unpaid Employee as Creditor: Case Comment on Homeplan Realty” (1980) 6 Dalhousie LJ 148

¹²⁴ *Hansard*, 10 February 1897, 84–85

This picture of the defenceless and prejudiced employee is no longer a full and accurate portrayal of the system. The Harmer Report¹²⁵ questioned whether this rationale was still valid, because it felt that the development of a sophisticated social welfare system had changed things, and the fact that some unsecured creditors may be dependent upon payment to maintain the solvency of their business. These persons are, according to the Report, in an employee-like relationship with the insolvent. However, the Report did accept that there was strong community support for retaining the employee priorities.¹²⁶

On the insolvency of an employer in England, the scheme of the Employment Rights Act 1996 ("ERA") provides for different and generally more extensive protection for an employee than under the Insolvency Act. As we have seen, the latter Act provides essentially for unpaid wages up to a maximum of £800 and any accrued holiday pay. ERA, s 182 provides *inter alia* for up to 8 weeks arrears of pay, wages during the statutory minimum notice period,¹²⁷ up to 6 weeks holiday pay and a basic award for unfair dismissal.¹²⁸ "Pay" is defined widely. Where payments are to be calculated by reference to weekly pay, the maximum amount which can be used in the calculation is £220.¹²⁹

The ERA scheme is beneficial to employees as payment from the Secretary of State is likely to be quicker than from a liquidator. It is also likely to be a larger payment than the employee will receive under the Insolvency Act. This is because the financial limits are potentially higher, eg 8 x £220 is more than £800, and also because certain payments such as a basic award for unfair dismissal do not have preferential status under the Insolvency Act.

The Secretary of State must make the payments out of the National Insurance Fund and stands in the shoes of the employee in attempting to recoup such money from the liquidator. A large proportion of the payments made do not have preferential status. In his report on the Redundancy Payments Service, which makes the payments on behalf of the Secretary of State, the Comptroller and Auditor General¹³⁰ highlights this point. As at 31 March 1996, £762 million was owed by insolvent employers to the Fund, of which only £177 million (23 per cent) ranked as preferential. The Fund was an unsecured creditor for the remaining £585 million.¹³¹

The preferential debts' regime appears to benefit the Crown and employees. However, once employees' rights under ERA are factored into the overall picture, it can be seen that the Crown, by subrogation, takes over the claims of employees in a very large proportion of cases and is often the sole preferential creditor.

Less than a quarter of the money paid out under the ERA scheme can be claimed back by the Crown as preferential. The public interest demands that protection is given to employees of insolvent employers. Out of the respondents to our questionnaire who wished to retain some preferential debts, 22% wanted to see increased protection for employees under the Insolvency Act. Our question was not sophisticated enough to distinguish between those who wanted an increase in employee entitlement under the

¹²⁵ Para 722.

¹²⁶ *Ibid*, para 726.

¹²⁷ As laid down in ERA, s 86.

¹²⁸ Under s167 ERA redundancy payments may in certain circumstances also be made by the Secretary of State out of the National Insurance Fund.

¹²⁹ Employment Rights (Increase of Limits) Order 1998 (SI 1998 No 924).

¹³⁰ HC 695 Session 1995-96.

¹³¹ *Ibid*, para 1.9.

Insolvency Act and those who wished to see the ERA scheme extended further. It is submitted that wide ranging protection already exists to a large extent under the ERA scheme. If employees' preferential status was lost under the Act the loss would fall on the National Insurance Fund, not on the employees. Again, it could be argued that such a loss to government coffers would be insignificant compared with the government's total expenditure but would free up significant sums for unsecured creditors.¹³²

It might be argued that trade unions would vigorously oppose the abolition of the priority granted to employees. Certainly unions made submissions to the Cork Committee¹³³ that the priority of employees should not only be retained but should be without limit. It is submitted that the opposition of the unions would not be as robust as often portrayed because of the fact that in practice benefits are paid by the National Insurance Fund and employees do not lose out.

2. The empirical evidence

In considering the subject of this article we felt that it was appropriate not only to examine the historical and legal aspects of the preferential debts' regime, but also to seek to secure some empirical data concerning its effects and workings in practice. Hence, we sent a questionnaire to 225 licensed insolvency practitioners and received 77 replies.

The questionnaire was divided into three parts. Section A sought responses in order to gauge whether respondents felt that the regime precipitated problems – are its effects positive, neutral or negative in relation to certain specific issues, namely creditor attitudes, the administration of estates, rescues and the initiation of winding up proceedings? Section B sought estimates from practitioners in relation to what is the fate of funds payable by liquidators. Section C canvassed the views of practitioners, in light of their experience, on the abolition or alteration of the rights of preferential creditors. In the following discussion we have rounded percentages to the nearest whole number.

(a) Section A

In this section we gave the practitioners a number of statements and asked them to respond. Five options were open to the respondents. They could answer under any one of the following: strongly disagree, disagree, no view, agree or strongly agree.

In response to the statement, "the current regime for the payment of preferential debts precipitates unsecured creditor discontent," 68% of our respondents either agreed or strongly agreed. Ten percent of respondents did not have a view and 22% disagreed with the statement (only 4% disagreeing strongly).

Fifty per cent of the respondents were of the view that the resolution and payment of preferential debts prolonged the winding up process. While 11% had no view on the matter, 39% felt that the process was not prolonged. In relation to whether the resolution and payment of preferential debts increased the costs of winding up, 47% were of the opinion that it did, 15% had no view and 38% thought that it did not increase costs.

¹³² The commentators mentioned *supra*, n 125 generally all favour *inter alia* some form of wage earner protection fund similar to the ERA scheme.

¹³³ At para 1430.

Due to the modern emphasis on rescuing viable business undertakings, we also asked our respondents to comment on what effect, if any, the Crown's priority had on proposed corporate rescue packages. Seventy eight per cent of respondents said that the priority enjoyed by the Crown diminished the possibility of rescue. Only 3% had no view and 19% felt that the priority did not effect the prospects of a rescue.¹³⁴ Still on the issue of corporate rescue, we asked practitioners to comment on whether the Crown seemed to have a general policy of voting against rescue packages. Sixty two per cent took the view that the Crown did appear to have such a policy. Eleven per cent expressed no view and 27% said that the Crown did not appear to have that policy. Following on, practitioners were asked if they thought that the Crown would become more amenable to agreeing to rescue packages if its preferential status was abolished. Fifty one per cent answered in the affirmative, 15% had no view and 34% responded in the negative.

Finally, 82% of respondents took the view that having a priority did not make it less likely that the Crown would initiate winding up proceedings. Twelve per cent had no view and only 6% felt that the priority made it less likely that the Crown would take liquidation proceedings. As discussed earlier in the article, this response is contrary to the frequently expressed views of the great majority of commentators.

(b) Section B

In answer to the question, in what percentage of insolvent windings up have distributions to preferential creditors absorbed the company's assets? only 65 of the respondents answered the question. Fifty five per cent of respondents said that preferential creditors took the assets of companies in 60% or more of cases.

When it came to responding to the question of what percentage of insolvent liquidations has a dividend been paid to unsecured creditors 85% of the practitioners (again only 65 responded to the question) said that it was in 30% or less of cases.

Finally, respondents were asked, in those insolvent windings-up where there were floating charges, had the floating charges absorbed the company's assets? Sixty one practitioners responded and the views given demonstrated no pattern. Twenty-nine percent gave as their answer : 10% or less. Ten per cent said that charges absorbed the assets in 21-30% of cases, while another 10% gave 41-50% as their answer. At the other end of the spectrum 13% said that the answer was in the range of 71-80% and 13% took the view that it was in 91-100% of liquidations.

(c) Section C

In this section of the questionnaire practitioners were asked a preliminary question: would you abolish preferential debts? The answer to this question determined whether the respondent needed to proceed to answer the balance of the questions in the section. Forty six percent of respondents said that they would abolish preferences, and their answer to any further questions was not requested. The other 54% went on to answer several more questions. First, 32% of practitioners who answered indicated that they would advocate the abolition of the Crown's preferential status. In answer to another question only one

¹³⁴ It seems that the preferential status of the Crown is regarded in the business world as an inhibitor to the implementation of rescues: D Wighton, "Tax bodies may lose preferential creditor status", *Financial Times*, 3 November 1998.

practitioner said that the Crown's priority should be extended in any way. This meant that, out of all our respondents, 62% would abolish the Crown's preferential status.

Ninety five percent of respondents who answered this section of the questionnaire said that they would not abolish the preferential status of employees, although only 43% said that they would extend the employees' preference position. It is not clear whether those wanting to retain the preferential treatment of employees wanted to retain the rights provided in the ERA scheme or the benefits granted pursuant to the Insolvency Act. What is not to be forgotten is that overall, when one takes into account the respondents who wish to see the abolition of all preferences, 47% of all respondents were in favour of abolishing employee preferences.

Sixty per cent of respondents said that they would not introduce a new category of preferential creditor – the consumer debtor who has made prepayments for goods and/or services to companies which end up in insolvent liquidation. Finally, 97% of practitioners said that they would not introduce any other new class of preferential creditor.

3. Summary

With the preferential regime as it stands at the moment, we could see the situation where creditors refrain from taking winding up proceedings against an insolvent company because it is known that there are substantial amounts owed to the Crown. Creditors would not proceed because they would realise that it is very possible that they would not see any of what was owed to them. They may well recover the taxed costs of obtaining a winding up order but they would be liable to pay their solicitors and counsel more than is likely to be awarded to them on a taxation and in any event they would be wasting their time in taking the proceedings. There is a public policy issue here. If creditors refrain from taking proceedings, we end up with a hopelessly insolvent company that could continue to trade and obtain more and more credit, from people who are unaware of the company's predicament, with no hope of repaying what is borrowed. The ultimate result is that creditors will obviously lose out.

Besides the lack of fairness which exists where some unsecured creditors get paid and others do not, there are other benefits of abolishing preferential treatment. First, it is likely that abolition would save costs and lead to more speedy windings-up.¹³⁵ Second, there would be more chance of a rescue of a company.¹³⁶ Third, more funds would be paid to the unsecured creditors.¹³⁷ Fourth, if the regime were abolished, banks would not spend the time and money which they presently do seeking ways of circumventing the effects of the regime. At present the preferential creditors are entitled to be paid prior to a creditor who holds a floating charge over company assets.¹³⁸ Banks and other lenders

¹³⁵ The response to the question in our questionnaire concerning the effect of the regime on the winding up process which attracted the most support was that the regime did prolong the process (50%). Again the response which attracted the most support in relation to whether the regime increased costs was that it did (47%).

¹³⁶ Seventy-eight of all respondents to our questionnaire felt that the Crown priority reduced the possibility of a rescue package being implemented.

¹³⁷ For example, a clear majority of respondents (55%) said that preferential creditors absorbed the funds available for distribution in more than 60% of cases.

¹³⁸ S 175(2)(b).

have sought ways of ensuring that they hold fixed charges as the holders of such charges are not subject to the preferential creditors' regime.¹³⁹

It is acknowledged that, if preferential debts were abolished, the holders of floating charges would benefit, as there would be no class of debt having priority over such creditors. This is an unintended benefit which unsecured creditors can do nothing about and this article does not purport to comment on the rights of floating charge holders, as that is another question.¹⁴⁰ But, if the regime were abolished, the fact is that unsecured creditors would receive more than they do at present. In any event many banks and other lenders are not securing their loans with floating charges as often as in the past; more and more they are now taking fixed charges over property which has traditionally been the subject of floating charges, as there is more of an arguable case that this is permissible.¹⁴¹

F. CONCLUSION

The creditors who lose out when it comes to a winding up are creditors who are not within any of the classes included in the preferential creditors' regime, and who are unable to maximise their benefits and minimise their risks by obtaining security or other forms of priority such as retention of title. These creditors who constitute the general body of unsecured creditors are clearly disillusioned by the winding up process,¹⁴² as is clearly manifested by the fact that 68% of the respondents to our questionnaire agreed that the present regime causes creditor discontent.

The present preferential regime was developed in an ad hoc fashion and, for the most part, not based on sound, or any, policy considerations. It is submitted that there are few, if any, adequate policy reasons for retaining the present regime, and no conclusive arguments have been proffered to support retention. It is contended that there are a number of sound historical, legal, practical and philosophical reasons which favour abolition. It has been argued here that on balance the better view is that the Crown's priority should be abolished and this was the opinion of 62% of our respondents. The issue of employee priority is not so clear-cut. Clearly there is significant sympathy for employees and so there was not such a high degree of support for the abolition of the employee preference when compared with the Crown priority, but it may be that respondents did not take into account the role played by the National Insurance Fund, which means that employees do not lose out in a winding up.

¹³⁹ *Re Lewis Merthyr Consolidated Collieries Ltd* [1929] 1 Ch 489; *Re GL Saunders Ltd* [1986] 1 WLR 215.

¹⁴⁰ If Parliament did decide to abolish preferential debts, it may also wish to reconsider the Cork Report's recommendation, at para 1538, for a 10% fund to be set aside for the benefit of unsecured creditors. The secured creditors' position would in the round not be greatly affected as, although they would lose their claim to the 10% fund, they would benefit from the abolition of preferential debts.

¹⁴¹ See R Gregory and P Walton, "Fixed Charges Over Changing Assets—The Possession and Control Heresy" [1998] CflLR 68.

¹⁴² While the preferential debts regime is the focus of this attitude, it would be wrong to lay all of the blame at the door of the regime. Creditors are also not helped by the impotence of the avoidance provisions in ss 238–245 of the Act. See the comments of A Keay in "Preferences in Liquidation Law: Time for a Change" [1998] CflLR 198.

The abolition of all preferential debts may seem to be rather radical. Yet Professor Goode canvassed that exact step way back in 1980.¹⁴³ It is respectfully submitted that the 1980 plea made by Professor Goode that English insolvency law recaptures the spirit of equitable distribution “which is at the heart of any civilized bankruptcy system”¹⁴⁴ needs to be repeated; for, although the 1986 reforms improved the lot of unsecured creditors, they continue to be the poor relations of liquidations, and, for the most part, equal distribution remains only as a theoretical concept.

¹⁴³ “The Death of Insolvency Law” (1980) 1 Co Law 123, 129, although it must be pointed out that the learned commentator saw the drastic reduction in scope of preferential debts as a possible alternative to abolition.

¹⁴⁴ *Ibid.*

The landlord, his distress, the insolvent tenant and the stranger

Peter Walton

At a glance

- The landlord's self-help remedy of distress remains complex and rooted in antiquity.
- Its operation in relation to the goods of insolvent tenants and third parties is inconsistent and a product of piecemeal amendments rather than informed study.
- If insolvency law is to be tidied up, the *pari passu* principle needs to apply to all unsecured creditors. Root and branch alterations to distress can be overlooked no longer.

Introduction

A landlord's power to distrain for unpaid rent 'is a remedy which enables landlords to recover arrears of rent, without going to court, by taking goods from the demised property and selling them'.¹ The landlord can levy distress personally or authorise court-licensed bailiffs to carry out the distraint. It may be levied as soon as rent is in arrears without prior notice to the tenant. Somewhat surprisingly perhaps, the goods distrained need not belong to the defaulting tenant. The origin of this common law self-help remedy lies in pre-Norman times.² It has been subject to common law and statutory modifications, introduced in an entirely *ad hoc* manner over a period of a thousand years. Some restrictions have been placed upon its operation, importantly, for example, landlords of residential tenancies will usually be required to obtain the permission of the court before distraining.³ Certain goods, those with absolute privilege, cannot be distrained at all.⁴

Although Lord Denning MR regarded distress in 1968 as 'an archaic remedy which has largely fallen into disuse',⁵ it made something of a comeback during the recent recession and remains an effective tool in the landlord's armoury of weapons against a defaulting tenant.⁶ Distress is of particular use where the tenant is insolvent as it may enable the landlord to jump the queue of unsecured creditors. The extent to which the landlord is entitled to gain such a priority position varies considerably depending upon which insolvency procedure the tenant has entered. The purpose of this article is to examine how distress is treated when the tenant becomes insolvent and why the law is as it is. It will also consider possible reforms of the system.

Distress against the goods of a stranger (or other third party)

Even if the tenant is hopelessly insolvent with no assets, a landlord may still be able to distrain effectively. At

common law the general rule is that all goods on the premises, including those belonging to a third party, are subject to the distress. Before considering how distress is treated in the various formal procedures under the Insolvency Act 1986, it is first important to understand how distress affects third parties.

The fact that a landlord is able to seize and sell goods belonging to third parties was judicially described in 1908 as 'extraordinary ... in a country which boasts of civilization, which purports to protect the property of the law-abiding citizen ...'.⁷ Largely as a result of this *dictum* the Law of Distress Amendment Act 1908⁸ was passed as an attempt to protect the goods of third parties from distress. In general terms, when the goods of a third party are distrained, the third party may serve a notice on the landlord under section 1 of the Act declaring ownership of the goods. The landlord cannot thereafter proceed with the distress.⁹

In practice, there are a number of problems with the notice procedure. First, third parties cannot serve a section 1 notice if they have 'any beneficial interest'¹⁰ in the tenancy. A debenture holder, for example, with a fixed and floating charge over a corporate tenant's lease and undertaking, could not, it seems, claim section 1 protection for any of the goods on the premises, as the debenture holder would have a beneficial interest in the tenancy by its fixed charge or by its crystallised floating charge.¹¹

Second, the third party may not even know that the goods have been distrained. Often walking possession is taken by a landlord which means that the goods remain on the demised premises. Even an extremely vigilant third party may be unaware that the seizure has occurred. A landlord can usually sell goods seized after a delay of only five days. As there is no requirement that notice be given to a third party whose goods are distrained, there is every chance that a landlord who acts quickly can sell the goods before any section 1 notice can be served.

Third, not all goods can be protected under section 1. Section 4 of the Law of Distress Amendment Act 1908 lists a number of exceptions including goods belonging to the tenant's spouse or business partner. Section 4A¹² generally denies protection for any goods subject to a bill of sale,¹³ conditional sale agreement or hire purchase agreement.¹⁴ Hire purchase companies can in certain circumstances sidestep this exception by inserting a contractual provision that the hire purchase agreement is to determine if the landlord threatens to or does take steps to levy a distress.¹⁵ Goods which belong to the hire purchase company are thereafter no longer goods subject to a hire purchase agreement and so fall within the general protection of section 1.¹⁶

Under section 4, goods which are in the order and disposition of the tenant with the consent of the true owner, and in such circumstances that the tenant is the reputed

owner, are not protected. This may apply to hire purchase goods even if the agreement has been effectively terminated by the distress. The order and disposition clause is borrowed from the old Bankruptcy Acts. It first appeared in 1623¹⁷ and was only removed from bankruptcy law in 1985.¹⁸ The general policy behind the order and disposition clause, in the context of distress, is that any third party who allows a tenant to have possession of the third party's goods, as if the tenant were the true owner, cannot complain if the landlord is deceived by this appearance of ownership and distrains the goods.

At first blush it would appear that the order and disposition clause would cover most hire purchase, conditional sale and hire goods as well as goods supplied on a sale or return basis or subject to retention of title. However, a recent Court of Appeal decision appears to limit the ambit of the clause. In *Salford Van Hire (Contracts) Ltd v Bocholt Developments Ltd*¹⁹ a plain white van had been hired out to a tenant company and following non-payment of rent by the tenant, had been distrained by the landlord. The van was three years old and had no markings on it which identified the true owner. It had also undergone a specific conversion to make it suitable for the tenant company's business. If any hire goods could be said to be in the reputed ownership of the tenant, this van was it.

The court decided that the van was not in the company's reputed ownership and therefore the hire company was able to claim the protection of section 1.²⁰ The court adopted a very strict test for reputed ownership. Only if, in all the circumstances, the tenant held the van in such a way that it appeared it 'must' have been the owner would it be considered to be in its reputed ownership. The court took judicial notice of how common such hiring agreements are in business, and concluded that the landlord was unable to show that the goods fell within the section 4 exception. Indeed, the court suggested that the landlord should have made enquiries of the DVLC in Swansea in order to ascertain who was the true owner.²¹ As the register of vehicle ownership at Swansea is not open to public inspection, this appears to put an impossibly onerous burden on a distraining landlord. What it does seem to indicate is a very restrictive approach by the modern courts in limiting landlords' attempts to use the order and disposition clause to distrain a third party's goods. The Court of Appeal's decision seems logically to extend to all conditional sale, hire purchase and retention of title agreements. Therefore creditors under such agreements, who are able to claim the benefit of section 1, are less likely to fall foul of a successful claim by a landlord that the goods are within the tenant's order and disposition and capable of being distrained.

Although the power of the order and disposition clause may have been largely diminished by *Salford*, the landlord can quite clearly still distrain a third party's goods and may, if swift to sell, still be successful. Of course, a section 1 notice is of no use to a third party if the goods have already been sold.

In considering any statutory or common law restrictions on the right to distrain against an insolvent tenant, it needs to be borne in mind that the restrictions will not extend to the goods of a third party. Subject to the rules outlined above, a third party's goods will still be at the mercy of a landlord.

Individual insolvency

Bankruptcy

Prior to 1825 there was nothing to prevent a landlord distraining against the estate of a bankrupt tenant. Section 74 of the Bankruptcy Act 1825²² introduced one mild form of limitation. Once the bankruptcy had commenced, the landlord was limited in distraining for no more than one year's rent accrued due prior to the bankruptcy order. The landlord was reduced to proving for any amount over that figure as an unsecured creditor. There remained no restriction on distraining before the bankruptcy commenced²³ for the whole amount owed.

This limited protection of the bankrupt's estate has survived in substance through subsequent Bankruptcy Acts. The period of one year prior to the commencement of bankruptcy was reduced to six months by section 28 of the Bankruptcy Act 1890. The relevant provision today is section 347 of the Insolvency Act 1986. Bankruptcy nowadays commences on the date of the bankruptcy order.²⁴ However, in the context of distress, this is effectively backdated in that, if a landlord distrains after the petition but before the order is made, any sum realised in excess of six months' rent is to be held for the bankrupt as part of his estate.²⁵ The impact on landlords of section 347 is not always too serious. For example, if rent is paid quarterly and the tenant becomes bankrupt, the landlord can still distrain at the end of the quarter for the full quarter's rent.²⁶

The restriction on claiming six months' rent only applies to rent due before the bankruptcy order. If subsequent to the order, the trustee in bankruptcy remains in possession of the demised premises without disclaiming the lease, the landlord can distrain for all rent accruing after the bankruptcy order.²⁷ Essentially this means that a trustee who remains in possession of the demised premises must pay rent for occupying the premises.

If a landlord distrains and the tenant becomes bankrupt within three months the landlord may lose some or all of the benefit of the distress under section 347(3). This subsection applies if the bankrupt's estate is insufficient to meet the debts owed to preferential creditors.²⁸ If section 347(3) applies, the goods which have been distrained or the proceeds of their sale are charged for the benefit of the bankrupt's estate with the preferential debts. Therefore, although distress allows the landlord to jump the queue of unsecured creditors, it does not, in the circumstances of section 347(3), give the landlord priority at the expense of preferential creditors. A similar provision to section 347(3) applies in the compulsory liquidation of companies.²⁹

Bankruptcy law is only concerned with administering the bankrupt's estate for the benefit of creditors. It has no impact upon the goods of third parties. The section 347 restriction cannot therefore be relied upon by any third party.³⁰ In this context a 'third party' may include a mortgagee of goods.

A mortgage of goods involves the transfer of title to the mortgagee which is transferred back to the mortgagor upon payment of the debt.³¹ Although title is transferred to the mortgagee, the mortgagor retains the equitable right to

redeem the mortgage. In equity the mortgagor remains the owner of the goods subject to the mortgage. As a general rule it would be 'flying in the face of all equity to hold that the goods are the "property" of the mortgagee'.³²

However, where the sum secured is in excess of the value of the goods, the court has held that the mortgagee is the owner of the whole property in the goods.³³ Therefore such a mortgagee in being treated as the owner of the mortgaged goods cannot rely upon section 347 but can rely upon the general rules relating to third party protection. However, as the mortgage would be a bill of sale³⁴ it would usually fall within the exceptions listed in section 4A and therefore fall outside the protection of section 1 of the Law of Distress Amendment Act 1908.³⁵ The landlord could therefore distrain the goods without being subject to the six months' limitation under section 347. It has been held that the power to distrain goods subject to a bill of sale survives even after the holder of the bill of sale has seized the goods and is about to have them sold at auction.³⁶

Goods which are merely subject to a charge are still strictly speaking owned by the bankrupt as a charge does not involve 'a transfer of legal or equitable ownership'³⁷ and would therefore fall within the scant protection of section 347 but outside the third party protections of section 1.³⁸

Individual voluntary arrangement

Since the provisions of the Insolvency Act 1986 came into force, debtors wishing to avoid bankruptcy have been able to reach a binding agreement with their creditors, by obtaining a majority greater than 75 per cent in value of the creditors, voting in favour of an individual voluntary arrangement (IVA) proposal. Once the IVA is approved it binds every person who had notice of, and was entitled to vote at, the creditors' meeting called to consider the proposal.³⁹ If the arrangement covers rent owing to the landlord, it will prevent the landlord from distraining on the basis of it, even if the landlord voted against the proposal. There is nothing to prevent the landlord from distraining prior to the creditors' meeting if rent is unpaid. By doing so, the landlord will avoid being bound by the IVA. A distress at this time will almost certainly have the knock on effect of destroying any possibility of the IVA being workable.

An attempt to prevent creditors in general frustrating IVA proposals, is the interim order procedure.⁴⁰ Its purpose is to allow an individual debtor time to prepare an IVA proposal to put to the creditors. It creates a temporary breathing space during which time no bankruptcy petition may be presented or proceeded with and 'no other proceedings and no execution or other legal process may be commenced or continued' except with leave of the court. *McMullen & Sons Ltd v Cerrone*⁴¹ decided that this moratorium on actions only covers rights of creditors which require the court's assistance for enforcement. Distress patently does not, and therefore there is nothing to prevent a landlord ignoring the interim order, distraining the tenant's goods and in so doing, destroying the prospects of the IVA proposal being successful. This gap in the moratorium is currently being considered by Parliament⁴² and it is envisaged that the moratorium will be extended to cover distress.

Corporate insolvency

Compulsory liquidation

Compulsory liquidation is a winding up of a company by order of the court. The most common winding-up order is based upon a creditor's petition that the company is unable to pay its debts. It is, in effect, the corporate equivalent of an individual's bankruptcy. The rules for governing how distress is treated in compulsory liquidation have a different origin from the rules in bankruptcy. Under the Winding Up Acts 1848 and 1849 there were hardly any limitations on the rights of creditors generally to enforce their rights against the company.⁴³ However, 'The Companies Act 1862 proceed[ed] upon an entirely different principle; the leading idea being that when the winding up of a company has once commenced, its creditors ought to be paid *pari passu*'.⁴⁴

To this end, section 85 of the 1862 Act stated that at any time after the presentation of the petition but before the making of a winding-up order, the court could, on the application of the company or any creditor or contributory, restrain any action, suit or proceeding pending against the company. Section 87 provided that after a winding-up order was made, no action, suit or other proceeding could be proceeded with or commenced against the company without leave of the court. Also, under section 163 any attachment, sequestration, distress or execution put in force against the company following the commencement of winding up⁴⁵ was void to all extents. Under section 163 'put in force' as it applied to distress refers to when the distress was levied initially. The distress need not have been completed by sale.⁴⁶

These provisions of the Companies Act 1862 have survived today. Sections 85, 87 and 163 are now substantially re-enacted in sections 126, 130 and 128 respectively of the Insolvency Act 1986.

A landlord's distress has always been held to be a type of 'proceeding' for the purposes of sections 126 and 130⁴⁷ even though the principle upon which the courts have acted would seem, at best, questionable. The meaning of 'proceeding' usually implies a court process.⁴⁸ In 1887 Cotton LJ thought it:

'... doubtful whether, having regard to the express words of section [128], which says, "That any distress shall be void", it was right to say that section [130] included distress among the "proceedings which the court might allow"'.⁴⁹

Despite this opinion his Lordship felt bound by the previous decision of Turner LJ in *Re Exhall Coal Mining Co*⁵⁰ to hold that 'proceeding' included distress. Therefore the ultimate result was, that a landlord could apply for leave under what is now section 130 to distrain even after the commencement of the winding up. Despite judicial doubts this remains the law today.⁵¹

A distress put in force after the commencement of winding up is void under section 128 unless the court gives leave under section 130. The courts will not usually permit a landlord to levy distress after the winding up has commenced for rent accrued due before the winding up which is provable in the winding up.⁵² This would offend

the policy of *pari passu* distribution amongst all the unsecured creditors.

Rent accrued due after the commencement of the winding up is in general required to be paid otherwise leave will be given to distrain for it. If the landlord applies to the court for leave to distrain under section 130, he must usually show that it is inequitable for the liquidator to insist upon section 128. If the liquidator wishes to use the demised premises for the purposes of the winding up the rent must be met.⁵³ The rent is seen as an obligation for the benefit of the estate.⁵⁴ Nowadays, it seems likely that the rent will need to be met unless the liquidator chooses to disclaim the lease under section 178–9 of the Insolvency Act 1986.⁵⁵

If the distress has been levied before the commencement of winding up, but has not been completed by sale, the court will almost certainly not restrain the sale. After the petition but before the winding-up order the company, any creditor or contributory may apply to restrain the distress under section 126. Once the winding-up order is made, in order to continue with the distress the landlord must apply for leave under section 130. The courts will only stay the distress if there are special reasons which show that to allow it would be inequitable.⁵⁶ This will require evidence of fraud or unfair dealing.⁵⁷ In this context it is not unfair dealing for the landlord to prevent the *pari passu* rule applying by sweeping off all the assets in the distress.⁵⁸

Voluntary liquidation

A voluntary liquidation is one where the company's members commence the winding up out of court by passing a resolution to wind up the company. In relation to voluntary liquidation there is no provision in the Insolvency Act 1986 preventing the landlord distraining. However, under section 112 of the Insolvency Act 1986⁵⁹, a liquidator, creditor or contributory of a company in voluntary liquidation may ask the court to exercise any power it has in relation to companies in compulsory liquidation. This includes the power to stay any distress.⁶⁰ The court's discretion will be exercised on the same grounds as for a compulsory liquidation. A landlord who acts swiftly by completing the distress before the liquidator applies to the court is safe, as the distress cannot later be invalidated.

In either type of liquidation the landlord is not prevented from distraining on the goods of third parties (subject to the rules on privileged goods and the Law of Distress Amendment Act 1908). If the third party itself is in liquidation, the landlord is not prevented from distraining its goods as the restrictions in the Insolvency Act, upon distress, only apply to landlords who are creditors of the third party in liquidation.⁶¹

Administrative receivership

A company which borrows money will frequently give security in the form of a debenture which charges its entire undertaking (which has been interpreted as meaning all its assets both present and future).⁶² The debenture will normally be in the form of (a) a fixed charge over assets which by their nature do not change day to day such as plant, machinery and buildings; and (b) a floating charge over circulating assets such as stock in trade. If the

company defaults under the terms of the debenture the chargee will usually appoint a receiver to realise the charged assets and pay off the chargee. If the debenture includes a floating charge and is over the whole or substantially the whole of a company's undertaking the receiver will be an administrative receiver.⁶³ Such a receiver owes a primary duty to the appointing debenture holder but is also deemed to be the agent of the company.⁶⁴

There appears to be no restriction on a landlord distraining against the goods of a corporate tenant in receivership.⁶⁵ This is logical in that the receiver acts as the agent of the company and therefore the property charged still belongs to the company and is under the control of its agent. There is no statutory provision preventing the distress and so it should be allowed.

The problem with this simple solution is that a number of cases may not be consistent with it. It is clear that a landlord may distrain over the assets of a company which are subject to a floating charge if the charge has not yet crystallised.⁶⁶ The assets charged remain the company's property and so are capable of seizure by the landlord. The position with regard to crystallised floating charges or charges which originate as fixed charges is not so clear.

The 'ordinary meaning' of what constitutes an equitable charge was given by Peter Gibson J as:

'... an appropriation of specific property to the discharge or other obligation without there being any change in ownership either at law or in equity, and it confers on the chargee rights to apply to the court for an order for sale or for the appointment of a receiver, but no right to foreclosure (so as to make the property his own) or take possession ...'.⁶⁷

Lord Hoffman has stated that a charge is 'created without any transfer of title or possession'.⁶⁸ Millett LJ has stated that a mortgage involves a transfer of legal or equitable ownership but that an equitable charge does not.⁶⁹ The conclusion from these *dicta* is that a charge does not involve a transfer of title or ownership. There is no assignment of the secured assets.⁷⁰ If this is correct, both fixed charge assets and assets subject to a crystallised floating charge will be the company's property and will not become the chargee's property. On this basis a landlord wishing to distrain such goods after the appointment of a receiver can do so free of any restriction.

There exist, however, several authorities which state that the crystallisation of a floating charge has the effect of assigning the charged assets to the chargee.⁷¹ If this is so, when an administrative receiver is appointed the floating charge will crystallise⁷² and effect an assignment of the secured assets to the chargee. One conceptual problem with this theory, which has been judicially expressed, is that it is difficult to see how, as agent of the company, the receiver is able to deal with and sell goods belonging to a third party (the chargee).⁷³

If it is accepted that crystallisation completes an assignment to the chargee, upon crystallisation the chargee as owner of the charged goods would be able to claim the protection of section 1 of the Law of Distress Amendment Act 1908. If, as is almost invariably the practice, the floating charge is taken over the tenant company's under-

taking, this would include any lease and would therefore preclude the chargee from asserting the protection of section 1, as the chargee would have a beneficial interest in the tenancy.⁷⁴ The chargee will be in no better position than if crystallisation had not completed an assignment of the goods. If the company is also in liquidation the chargee will be in a worse position as under the Insolvency Act 1986, protections from distress do not extend to goods belonging to third parties.⁷⁵ Only if the charge does not cover the demised property will the chargee be able to claim third party protection under section 1.

Two recent decisions⁷⁶ dealing with distress seem diametrically opposed as to whether or not crystallisation completes an assignment to the chargee. It may be that the decisions can be reconciled on the basis that an assignment of charged goods occurs only if, at the time of enforcement, the value of the goods is less than the security. This is how Kay J dealt with the matter in *Re New Constitutional Club Co.*⁷⁷ and it would be consistent with how the courts have dealt with bills of sale.⁷⁸ Certainly there is no clear answer. All that can be said, is that however the issue is viewed, a landlord should, in most instances, be able to distrain over the goods of a company in receivership.

Administration

A company which is insolvent may apply to the court for an administration order.⁷⁹ If the order is granted an administrator will be appointed to manage the company's affairs. The order will be made if the court believes it is likely that any one or more of the statutory grounds are satisfied. The order may be made (a) on the basis that it will lead to the survival of the company and at least part of its undertaking; (b) on the ground that it is likely to lead to a more beneficial realisation of the company's assets than would be possible under an immediate winding up (the order can be made even though winding up is envisaged in due course); or (c) on the ground that it will lead to the company reaching an arrangement with its creditors such as a company voluntary arrangement.

An administration order is only a temporary measure intended to give the administrator the opportunity to achieve the statutory ground(s) upon which the order was made. Similarly to an interim order in IVA's it creates a moratorium on creditor actions against the company. The administration order moratorium is in wider terms than that for IVA's in that it specifically prevents distress without the leave of the court or consent of the administrator. The moratorium comes into effect as soon as the petition is filed and continues after the order is made.⁸⁰ The purpose of the moratorium is to give the administrator time to put together a proposal for the creditors to consider, free from the molestation of creditors enforcing their rights against company assets.

The Court of Appeal in *Re Atlantic Computer Systems plc*⁸¹ has given general guidance on what matters the court should consider in an application for leave to enforce creditor rights. A landlord who applies for leave to distrain against a company in administration must convince the court that in the circumstances it is fair to allow distress. The court will balance the legitimate interests of the landlord, including the extent of the loss which the landlord would

suffer should leave not be granted, with the effect distress would have on the administrator's plans to maximise payments to the other creditors of the company. The case contains general guidance but it seems likely that, by analogy with the position in liquidation, an administrator who does not pay rent for at least the period after the order is made, will not convince the court to uphold the moratorium. Otherwise the landlord would effectively be financing the administration to the benefit of all the other unsecured creditors.

In addition to the possibility of distress, the landlord also has the power to forfeit by peaceable re-entry. This remedy has been held not to be within the moratorium and therefore can be exercised without the requirement of leave from the court.⁸² An administrator who needs the demised premises to carry on the business is unlikely to risk forfeiture by not paying rent.

Company voluntary arrangement

A company may enter into a voluntary arrangement in the same way as an individual.⁸³ The main difference between a company voluntary arrangement (CVA) and an IVA is that there is no corporate equivalent to the interim order. If a company wishes to put forward a CVA proposal to its creditors it has no protection from creditors' enforcements whilst it puts together the proposal. In order to achieve a freeze on creditors' rights the company must first obtain an administration order on the ground that a CVA is likely. If there is no administration order in place and a landlord is given notice of a creditors' meeting to consider a CVA proposal, there is nothing preventing the landlord distraining. The landlord will be bound by the terms of any approved CVA, where notice was given of the creditors' meeting to the landlord and the landlord was entitled to attend and vote.⁸⁴ It is binding even if the landlord did not attend or did attend and either did not vote or voted against the proposal.

Parliament is currently considering a proposal to introduce a moratorium to the CVA procedure similar to the interim order for IVA's. This proposal is designed to put an end to the requirement for an administration order to be obtained before a CVA proposal can realistically be drafted.⁸⁵

Reform

The way in which distress has been dealt with by insolvency legislation is not an object lesson in clear thinking and careful planning. Whenever a provision has been introduced into the law, such as the landlord's rights in bankruptcy, it has generally remained intact. The longer the rule survives, the less likely it seems it will be changed, even if it leads to an illogical and unfair system. Professor Goode has stated that the fundamental principle of insolvency law 'is that of *pari passu* distribution, for creditors participating in the common pool in proportion to the size of their admitted claims'.⁸⁶ The remedy of distress is a classic example of one unsecured creditor being able to ignore this principle.

Distress is remarkable in its disregard for the *pari passu* principle but even on its own terms it is inconsistent. In bankruptcy or receivership there appear to be no or only very minor limitations on its exercise. The law of distress

treats holders of bills of sale over individuals' property differently from holders of debentures over companies' property. Distress is treated in compulsory liquidation differently than it is in voluntary liquidation. It is prevented where a company is in administration and considering a CVA, but not where an individual has the benefit of an interim order and is considering an IVA. Although the insolvent tenant's assets may, to a greater or lesser extent, be protected, the landlord can usually still seize goods belonging to a third party. Much of the caselaw from the nineteenth century is still law even though it may lack clarity or has been heavily criticised by subsequent courts. This is all quite illogical.

The Law Commission⁸⁷ (and others)⁸⁸ has on more than one occasion called for the total abolition of distress. Its proposals lie in the Lord Chancellor's department waiting in vain to be put into effect. The reason for inaction appears to be a concern that landlords will be left with no effective remedy against a defaulting tenant. This seems a somewhat unconvincing reason. Once a tenant becomes insolvent, even disregarding the power to distrain, a landlord is still in a strong position. The landlord can usually forfeit the lease on the insolvency of the tenant. If the lease is valuable and the insolvency practitioner who is realising the estate wants to sell it, the landlord can demand payment of outstanding rent to prevent forfeiture. The landlord will frequently also have the right to demand rent from previous lessees due to the benefit of a chain of indemnity.⁸⁹ This latter right will still be available even if the lease itself is unsaleable and the trustee in bankruptcy or liquidator disclaims it.⁹⁰ It is clearly time for the Law Commission's recommendations of abolition to be implemented.

Conclusion

The Department of Trade and Industry has put forward some limited amendments to the Insolvency Act in relation to when distress may be levied against an insolvent tenant, but this is merely tinkering at the edges of a far larger problem. If the total abolition of distress is not possible, it is incumbent on Parliament to amend the law so as to bring certainty, fairness and consistency to all the types of formal insolvency procedure which a tenant may enter. It is particularly difficult to justify the right landlords have to distrain a third party's goods. There appears to be no convincing reason, even if distress as a remedy continues to exist, why it should be allowed to be levied once formal insolvency proceedings of any type have been commenced.⁹¹ If the Government is serious about abolishing the preferential debts regime⁹² it would be anomalous to retain the priority right which distress accords landlords. Fairness demands that there should be no exceptions to the *pari passu* principle for any unsecured creditors.

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NOTES

1. *Rhodes v Allied Dunbar Pension Services* [1989] 1 All ER 1161 at 1163 per Nicholls LJ.
2. See for example, II Cnut c.19 – the laws of Canute made between 1027 and 1034.
3. If the tenancy is a protected tenancy under Rent Act 1977, s 147 or an assured tenancy under Housing Act 1988, s 19, the landlord must obtain a court order before levying distress. Landlords of other

residential tenancies such as secure tenancies under the Housing Act 1985, which would include most local authorities, may continue to distrain without judicial permission.

4. For example, (a) fixtures – e.g. *Pitt v Shew* (1821) 4 B & Ald 206; (b) wearing apparel, bedding, tools of the trade and money – Law of Distress Amendment Act 1888, s 4, as amended by section 89 of the County Courts Act 1984 (which itself is amended by Courts and Legal Services Act 1990, s 15); (c) perishable items which cannot be returned to the owner in the same state as when distrained – e.g. *Morley v Pincombe* (1848) 2 Exch 101 – slaughtered pigs; (d) things in actual use at the time of distress – e.g. *Field v Adames* (1840) 12 Ad & El 649.
5. *Abingdon Rural District Council v O'Gorman* [1968] 2 QB 811 at 819.
6. It is outside the scope of this article to attempt anything more than the briefest of explanations of distress. For a full consideration of its detailed operation see *Halsbury's Laws of England* (4th edn) Butterworths, Vol 13 on 'Distress'.
7. *Challoner v Robinson* [1908] 1 Ch 49 at 55 per Neville J.
8. This statute built upon and expanded the protection previously limited to goods of lodgers of a defaulting tenant under the Lodgers' Goods Protection Act 1871.
9. Law of the Distress Amendment Act 1908, s 2.
10. *Ibid*, s 1.
11. *Cunliffe Engineering Ltd v English Industrial Estates Corp'n* [1994] BCC 972.
12. Inserted by Consumer Credit Act 1974, s 192(3) and brought into force by the Consumer Credit Act 1974 (Commencement No. 8) Order 1983 (SI 1983 No. 1551).
13. The holder of a security bill of sale cannot claim section 1 protection unless the bill of sale is a regulated agreement under the Consumer Credit Act 1974, and even then the protection is only available during the period between service of a default notice and the date on which the notice expires or is complied with.
14. Section 1 protection is not available for goods subject to hire purchase or conditional sale agreements which have not been terminated (except in relation to agreements regulated by the Consumer Credit Act 1974 during the period between service of a default notice and the date on which the notice expires or is complied with). Therefore the landlord can still distrain goods held by the tenant under a hire purchase or conditional sale agreement unless the agreement has been terminated or is an agreement regulated by the 1974 Act in respect of which a default notice is still current.
15. If the agreement is regulated by the Consumer Credit Act 1974, such automatic termination clauses are prohibited, with the consequence that the creditor may only claim the protection of section 1 of the 1908 Act if a default notice is already in existence.
16. See *Times Furnishing Co Ltd v Hutchings* [1938] 1 KB 775.
17. Sections 10 and 11 of 21 Jac. 1 c.19 (the Bankruptcy Act 1623).
18. When the Insolvency Act 1985 repealed the Bankruptcy Act 1914.
19. *Salford Van Hire (Contracts) Ltd v Bocholt Developments Ltd* [1995] CLC 611.
20. Although the wording of section 4A of the 1908 Act generally excepts hire goods from the protection of section 1, when the section was brought into force by Consumer Credit Act 1974 (Commencement No. 8) Order 1983, the provision regarding hire goods was not activated. Section 4A does not therefore prevent hirers of goods from claiming section 1 protection.
21. *Supra* n 19 at p 621.
22. 6 Geo. IV c.16 – the first modern bankruptcy statute.
23. I.e. before the act of bankruptcy relied upon for the bankruptcy order.
24. Insolvency Act 1986, s 278.
25. *Ibid*, s 347(2).
26. *Re Howell* [1895] 1 QB 844.
27. *Re Binns* (1875) 1 ChD 285.
28. As listed in Insolvency Act 1986, Sch 6.
29. Insolvency Act 1986, s 176.
30. *Brocklehurst v Lawe* (1857) 26 LJ QB 107.
31. *Maugham v Sharpe* (1864) 17 CB (NS) 443 at 464 per Williams J.
32. Sykes *The Law of Securities* (4th edn, 1986) Law Book Co, Sydney at p 756.
33. *Railton v Wood* (1890) 15 App Cas 363.
34. As defined by Bills of Sale Act 1878, s 4.
35. Unless the bill of sale is a regulated agreement under the Consumer Credit Act 1974, and a default notice is already in existence.
36. *London and Westminster Loan and Discount Co. v London and North Western Railway Co.* [1893] 2 QB 49.
37. *Re Cosslett Contractors Ltd* [1997] BCC 724 at 733 per Millett LJ.
38. *Supra* n 11.
39. Insolvency Act 1986, s 260(1).
40. *Ibid*, ss 252–255.
41. *McMullen & Sons Ltd v Cerrone* [1994] BCC 25, which has been considered with apparent approval in *Re a Debtor* [1996] BCC 57 at pp 64–5.

42. See the Select Committee on Trade and Industry's *Second Report on the Draft Insolvency Bill*, 14 December 1999.
43. See *Re India and Australia Steam Packet Co* (1849) 17 Sim 15 and *Hill v London and County Association Society* (1856) 1 H & N 398.
44. *Lindley on Partnership and Companies* (4th edn, 1878) Maxwell & Sons, London.
45. Under Insolvency Act 1986, s 129 a compulsory winding up commences on the date of the petition.
46. *Re Roundwood Colliery* [1897] 1 Ch 373; *Herbert Berry Associates Ltd v IRC* [1977] 1 WLR 1437.
47. *Re Roundwood Colliery*, *ibid*; *Re Great Ship Co Ltd* (1863) 4 De G J & S 63; *Venner's Electrical Cooking and Heating Appliances Ltd v Thorpe* [1915] 2 Ch 404.
48. See particularly the doubts expressed in *Herbert Berry*, *supra* n 46, at 1446A-C and 1448C-D *per* Lord Simon of Glaisdale and Lord Russell of Killowen. Both their Lordships adopt an *obiter* statement by Oliver J in *Re Bellaglade Ltd* [1977] 1 All ER 319 at 320.
49. *Re Lancashire Cotton Spinning Co* (1887) 35 ChD 656 at 661.
50. *Re Exhall Coal Mining Co* (1864) 4 De G J & S 377.
51. *Re Memco Engineering Ltd* [1986] Ch 86.
52. *Re Coal Consumers Association* (1876) 4 ChD 625; *Re Oak Pitts Colliery Co* (1882) 21 ChD 322.
53. *Re Silkstone Co* (1881) 17 ChD 158; *Re Lancashire Spinning Co*, *supra* n 49; *Shackell v Chorlton* [1895] 1 Ch 378.
54. *Re Lundy Granite Co* (1871) 6 Ch App 462.
55. This would be consistent with the rule in bankruptcy – see *supra* n 27.
56. *Re Roundwood Colliery*, *supra* n 46.
57. *Venner's Electrical*, *supra* n 47.
58. *Ibid*.
59. Originally Companies Act 1862, s 138.
60. *Herbert Berry*, *supra* n 46.
61. *Supra* n 54.
62. *Re Panama, New Zealand, and Australian Royal Mail Co* (1870) 5 Ch App 318 at 322 *per* Giffard LJ.
63. Insolvency Act 1986, s 29(2).
64. *Ibid*, s 44.
65. *Purcell v Public Curator of Queensland* (1922) 31 CLR 220; *New Cly Constitutional Club* (1887) 34 ChD 646 – leave of the court will be required to distrain if the receiver is court appointed.
66. *Re Roundwood Colliery*, *supra* n 46.
67. *Carreras Rothmans Ltd v Freeman Mathews Treasure Ltd* (1984) 1 BCC 99, 219 at 99, 222.
68. *Morris v Agrichemicals* [1997] BCC 965 at 972.
69. *Supra* n 37.
70. See also *Re Marriage, Neave & Co* [1896] 2 Ch 663 at 673 *per* Lindley LJ.
71. See *Re ELS Ltd* [1994] BCC 449 which relies heavily upon the set-off case *NW Robbie & Co v Wimey Warehouse Co* [1963] 1 WLR 1324 and the lien case *George Barker (Transport) Ltd v Eynon* [1974] 1 WLR 462.
72. *Evans v Rival Granite Quarries Ltd* [1910] 2 KB 979.
73. *Supra* n 11 at 976 *per* His Honour Judge Howarth.
74. It is also possible that the goods could be in the reputed ownership of the tenant which would take them outside the protection of section 1. This line of argument would appear to be weak in light of *Salford*, *supra* n 19.
75. *Supra* n 54.
76. *Re ELS Ltd*, *supra* n 71; *Cunliffe Engineering Ltd*, *supra* n 11.
77. *Re New Constitutional Club Co.* (1886) 34 ChD 646 at 650–1 approved by Wright J in *Re Harpur's Cycle Fittings Co.* [1900] 2 Ch 731.
78. *Supra* n 33. Company debentures are expressly made exempt from the Bills of Sale Acts by Bills of Sale Act 1882, s 17 – see *Re Standard Manufacturing* [1891] 1 Ch 627.
79. See generally, Insolvency Act 1986, Pt II.
80. *Ibid*, ss 10, 11.
81. *Re Atlantic Computer Systems plc* [1992] Ch 505 at 542–544.
82. See *Re Lomax Leisure Ltd* [1999] 2 BCLC 126 following *Razzaq v Pala* [1998] BCC 66.
83. See Insolvency Act 1986, Pt I.
84. *Ibid*, s 5(2).
85. *Supra* n 42, which at para 13 agreed with the Deputy Inspector General of the Insolvency Service that this was a 'modest but worthwhile proposal'.
86. *Goode Principles of Corporate Insolvency Law* (1990) Sweet & Maxwell, London at p 59.
87. *Law Commission Landlord and Tenant Interim Report on Distress for Rent* (1966); *Law Commission Working Paper No. 97 Distress for Rent* (1986), *Law Commission Landlord and Tenant Distress for Rent No. 194* (1991).
88. *Report of the Committee on the Enforcement of Judgment Debts* (1969, Cmd. 3909 – the 'Payne Committee').
89. But see the Landlord and Tenants (Covenants) Act 1995 which restricts such claims involving leases created after the commencement of the Act.
90. Under Insolvency Act 1986, ss 317–7, 178–9 respectively. See also *Hindcastle Ltd v Barbara Attenborough Associates Ltd* [1997] AC 70.
91. See the *Report of the Review Committee on Insolvency Law and Practice* (1982, Cmd. 8558 – the 'Cork Committee') at para 1667.
92. See the 'Review of Company Rescue and Business Reconstruction Mechanisms' at www.insolvency.co.uk/legal/corescue. Also see Keay and Walton 'The Preferential Debts Regime in Liquidation Law: In the Public Interest?' (1999) Vol 3 Part 1 *Company, Financial and Insolvency Law Review* 84 for a critique of the preferential debts regime.

LANDLORD'S DISTRESS—PAST ITS SELL BY DATE?

By Peter Walton

Introduction

A landlord's power to distrain for unpaid rent "is simply a right to resort to the chattels on the land in the occupation of the tenant".¹ It is a common law self help remedy requiring no order of the court to put into effect. It can be levied as early as the day after the rent falls due without any notice being given to the tenant. Nearly a hundred years ago, its effect on third parties was described as "extraordinary... in a country which boasts of civilization, which purports to protect the property of the law-abiding citizen...".² In feudal times distress was a new and useful remedy. In more modern times it has been commented that "[i]ts very existence as a legal remedy besmirches the fabric of English civil justice."³

The primary purpose of this article is to consider the efficiency and fairness of how the remedy of distress operates today and to assess whether it has a future. Not surprisingly, as a thousand-year-old remedy, it has endured a great many amendments over time and the law of distress consequently constitutes a very complicated remedy in practice. Its development needs to be traced in order to assess whether any of the historical justifications for its retention still hold good in the 21st century. Some of the more important problems with the remedy will be highlighted. Although Lord Denning M.R. regarded it in 1968 as "an archaic remedy which has largely fallen into disuse",⁴ distress has enjoyed a certain return to popularity amongst landlords in recent recessionary years. Frequent calls for amendment or abolition of distress have generally been met with parliamentary inaction. The controversy over distress remains very much a live issue and the remedy is currently being examined as part of the Lord

¹ *Re Coal Consumers' Association* (1876) 4 Ch. D. 625 at 629–630 per Malins V.-C.

² *Challoner v. Robinson* [1908] 1 Ch. 49 at 55 per Neville J.

³ Jacob, *The Fabric of English Civil Justice* (Stevens, London, 1987) p. 179.

⁴ *Abingdon Rural District Council v. O'Gorman* [1968] 2 Q.B. 811 at 819.

Chancellor's wide ranging *Review of Enforcement of Civil Court Judgments*.⁵

This article examines both the approach other jurisdictions have taken to distress and the potential impact of the Human Rights Act 1998. The latter examination is undertaken in order to assess whether the Human Rights Act holds the key to forcing Parliament finally to bring about the demise of this most ancient of legal landmarks of the common law world.

Historical Development

The precise origin of the landlord's power to distrain for unpaid rent is not clear. Enever⁶ traces its origins to pre-Norman times with the first specific reference to distress being in the laws of Canute made between 1027 and 1034.⁷ Bullen⁸ suggests that the law relating to distress was adopted by William I and became a means of enforcing feudal dues. By the reign of Henry I (if not before) it was necessary to obtain judicial approval before a distress could be levied.⁹ It seems the formality of a lord applying to his own court to obtain the necessary licence to distrain was soon dispensed with. The lord would distrain a tenant into the fulfilment of his feudal services without bothering to clothe himself with the authority of his own court. It thereafter became customary for the power of distress to be regarded as an incident of a lord's or landlord's status. The requirement for judicial authority disappeared altogether.¹⁰ At this time the right to distrain was limited to the right to seize and detain goods, whether belonging to the tenant or not, which were on the tenanted premises.

From this starting point the development of distress for rent may be divided into three separate stages. Firstly, the power of the lord to distrain was initially cut down by several statutes in order

⁵ The Lord Chancellor's Department has to date issued four Consultation Papers: *Enforcement Review: How can Enforcement of Civil Court Judgments be made more effective?* CP June 1, 1998; *Enforcement Review: Key Principles for a New System of Enforcement in the Civil Courts*, CP May 2, 1999; *Enforcement Review: Attachment of earnings orders, charging orders and garnishee orders*, CP October 3, 1999; *Enforcement Review: Warrants and Writs, Oral Examinations and Judgment Summonses*, January 2000 and has now reported on the review process thus far: *Enforcement Review: Report of the First Phase of the Enforcement Review*, July 2000.

⁶ Enever, *Law of Distress* (Routledge, London, 1937) pp. 2–3.

⁷ II Cnut c. 19. See also Plucknett, *A Concise History of the Common Law* (4th ed., Butterworths, London, 1948) pp. 86 and 570.

⁸ Dodd and Bullen, *Bullen on Distress* (2nd ed., Butterworths, London, 1899), pp. 5–7.

⁹ *Ibid.* at 4.

¹⁰ See also Pollock and Maitland, *History of English Law* (2nd ed. reissued, University Press, Cambridge, 1968), Vol. 2, pp. 574–578.

to protect the tenant from oppressive use of the remedy. Second, in a change of direction the rights of the distrainor were increased. Third, third parties whose goods became subject to distress were given some protection.

Powers of Distrainor Restricted

It is schoolboy history to recite that following the reign of William I the power of the barons grew substantially. What is not so widely known is that amongst the armoury of the barons was the power to distrain. The power was exercised upon fictitious allegations; excessive distresses were levied; services were wrongfully compelled;¹¹ the right to replevin ignored. Replevin was and is a remedy available to anyone who has had their goods distrained illegally. The procedure involves firstly the *replevy*, which is an application to the court for an order returning the goods to the tenant. This will normally be granted provided adequate security is given to cover the amount of alleged rent outstanding and the likely costs of the replevin action. Second, there is the action of *replevin*, where a hearing is held to consider if the distress was illegal and if so, to order that the claimant is entitled to the goods. If successful the claimant retains the goods and recovers costs and damages. Replevy will normally have to be made within five days of the distress.

Many statutes were passed which *inter alia* limited the amounts which could be distrained,¹² prevented the distrainor impounding goods and then taking them out of the county¹³ and later it was provided that the "pound" where the goods were to be held could not be more than three miles from the place of distress.¹⁴ With the gradual diminishing of the barons' powers further restrictions on distress became unnecessary. Throughout this period it should be noted that the distrainor was only empowered to seize goods and impound them off the premises. There was no power to sell the goods seized. Any attempt to sell the goods would impose liability on the landlord in conversion.¹⁵

Landlords Accorded Additional Rights

Thus far statutory intervention had been limited to protecting the rights of the tenant. As the centuries rolled by and the full

¹¹ See the preamble to the Statute of Marlbridge (or Marlborough) (1267) 52 Hen. III c. 1.

¹² Statute of Distresses of the Exchequer (1266) 51 Hen. III stat. 4.

¹³ Statute of Marlbridge (or Marlborough) (1267) 52 Hen. III c. 4.

¹⁴ An Act for the Impounding of Distresses (1554) 1&2 P. & Mary c. 12.

¹⁵ *Gomersall v. Medgate* [1610] Yelv. 194.

rigours of the feudal system disappeared, tenants became more sure of their rights. The royal courts' authority could not be challenged and the courts would enforce tenants' rights. The landlord's position became considerably weaker and so gradually Parliament began to redress the balance by giving new rights to the landlord. The following are some of the more important additions to the landlord's rights. They are discussed in the present tense as, somewhat surprisingly, these ancient provisions remain law today.

The Distress for Rent Act 1689¹⁶ provides that if the tenant or owner does not, within five days¹⁷ of the distress, replevy it with sufficient security, the distrainer shall be entitled to sell the assets seized. The distrainer must obtain the best price possible and hand over any surplus to the tenant.¹⁸ The Act specifically draws attention to the fact that holding the assets seized merely as a pledge with no power of sale, had given "little benefit"¹⁹ to the distrainer.

Fraudulent removal of goods from demised premises could avoid a distress until the Landlord and Tenant Act 1709²⁰ permitted the landlord to follow and seize the goods wherever they could be found.²¹ This power was augmented by the Distress for Rent Act 1737²² which expressly refers to the fact that previous statutes being "made for the better security of rents, and to prevent frauds committed by tenants, have not proved sufficient . . .". This latter Act also allowed distress to be levied over livestock and growing crops which was previously not possible.²³ The Act also introduced the ability to take walking possession, that is, leaving the assets on the tenant's premises on a specific undertaking by the tenant not to remove or dispose of them.²⁴

Until the 1737 Act any irregularity in the levying of the distress led to the distraint being rendered void *ab initio* and the tenant entitled to recover the full value of the unpaid rent. The rule at common law was that in such circumstances the distrainer was deemed to have intended a tortious act.²⁵ The levying of distress and selling of the assets had by now become a very complex

¹⁶ 2 W. & M. c. 5.

¹⁷ Section 6 of the Law of Distress Amendment Act 1888 subsequently gave the tenant the right to apply for an extension to 15 days in which to replevy.

¹⁸ See, e.g. *Hawkins v. Walrond* (1876) 1 C.P.D. 280.

¹⁹ Section 1 of the Distress for Rent Act 1689.

²⁰ 8 Anne c. 14.

²¹ See Dodd and Bullen, *Bullen on Distress* (2nd ed., Butterworths, London, 1899), p. 13.

²² 11 Geo. II c. 19, ss.1-7.

²³ *Ibid.* s.8.

²⁴ *Ibid.* s.10.

²⁵ See *Six Carpenters' Case* [1610] 8 Co. Rep. 147.

matter and the consequences of any error by the distrainor were serious. Section 19 of the 1737 Act displaced the *ab initio* rule with a rule allowing for damages to be awarded commensurate with the loss suffered.

Third Party Protection

Until the landlord was given a power to sell the assets seized, the rights of third parties were rarely interfered with. Whilst the landlord was limited to seize and hold property as a pledge pending payment, any third party whose assets had been seized could demand their return on threat of an action in detinue. The power of sale introduced in 1689 covered all assets on the premises regardless of who was the owner. The landlord therefore would seize whatever was on the premises even if aware that the tenant was not the true owner. In Victorian times Parliament passed a number of statutes which gave some protection to third parties.²⁶

The interests of lodgers of a defaulting tenant were first given protection under the Lodgers' Goods Protection Act 1871. This protection was repeated and extended to under tenants and other third parties by the Law of Distress Amendment Act 1908. This latter Act was introduced largely to remedy the faults highlighted by Neville J. in *Challoner v. Robinson*.²⁷ His Lordship was critical of a landlord's ability to seize and sell goods on the demised premises which belonged to a third party.²⁸ Under the 1908 Act, when the goods of a lodger, under tenant or stranger are distrained, that third party may serve a notice on the landlord under section 1 declaring ownership of the goods. On receipt of such a notice a landlord or bailiff who then proceeds with the distress is deemed guilty of an illegal distress.²⁹ If a notice is served by a lodger or sub-tenant, the relief under section 1 is conditional upon paying future rent to the landlord directly. One important restriction upon a third party's ability to serve a section 1 notice is that no notice can be served by a person who has "any

²⁶ See, e.g. s.14 of the Gasworks Clauses Act 1847, s.44 of the Waterworks Clauses Act 1847 and s.25 of the Electric Lighting Act 1882 which had the effect of protecting the assets of utility companies such as pipes and other fittings on a tenant's premises from distress. Section 3 of the Railway Rolling Stock Protection Act 1872 protects railway rolling stock which belongs to third parties.

²⁷ [1908] 1 Ch. 49.

²⁸ Neville J.'s comments quoted in the introduction to this article are part of his Lordship's criticism.

²⁹ Section 2 of the Lw of Distress Amendment Act 1908.

beneficial interest" in the tenancy. A secured creditor, for example, with a fixed and floating charge over a corporate tenant's lease and undertaking, would be unable to claim the protection of section 1 for any of the goods on the premises as the creditor would have a beneficial interest in the tenancy by its fixed charge.³⁰

Although an impressive looking protection for third parties, the notice procedure is flawed in practice as there is no duty on the landlord or tenant to notify the third party that the goods in question have been seized. Frequently walking possession is taken and so the goods remain on the premises and the fact that a distress has occurred may not be obvious. If the landlord acts swiftly by selling as soon as the five day period is over, the third party who has yet to serve a section 1 notice has no remedy against the landlord and is left to chase the (probably insolvent) tenant for the value of the goods seized.

The protection is also weakened in that not all goods can be protected in this way. Section 4 contains a number of exceptions including goods belonging to the spouse or business partner of the tenant. Under section 4A³¹ the holder of a security bill of sale cannot claim section 1 protection unless the bill of sale is a regulated agreement under the Consumer Credit Act 1974, and even then the protection is only available during the period between service of a default notice and the date on which the notice expires or is complied with.

The owner of goods subject to a hire purchase or conditional sale agreement can in theory claim the protection of a section 1 notice. However, section 1 protection is not available for agreements which have not been terminated, except in relation to agreements regulated by the Consumer Credit Act 1974, during the period between service of a default notice and the date on which the notice expires or is complied with.³² The potential risk to persons who finance hire purchase or other types of sale agreements can in certain circumstances be avoided by the insertion of a contractual provision whereby the agreement is terminated if the landlord threatens to or does take steps to levy

³⁰ *Cunliffe Engineering Ltd v. English Industrial Estates Corp.* [1994] B.C.C. 972.

³¹ Added by s.192(3) of the Consumer Credit Act 1974 and brought into force by the Consumer Credit Act 1974 (Commencement No. 8) Order 1983, S.I. 1983 No. 1551.

³² Section 4A of the Law of Distress Amendment Act 1908 as inserted by s.192(3) of the Consumer Credit Act 1974 and brought into force (except as to consumer hire agreements) by the Consumer Credit Act 1974 (Commencement No. 8) Order 1983, S.I. 1983 No. 1551.

a distress. Goods seized by the landlord are thereafter no longer subject to the agreement and the creditor can claim section 1 protection.³³ If the agreement is regulated by the Consumer Credit Act 1974, such automatic termination clauses are prohibited, with the consequence that the creditor may only claim the protection of section 1 of the 1908 Act if a default notice is already in existence.

A particularly problematic exception under section 4 involves goods which are in the order and disposition of the tenant with the consent of the true owner in such circumstances that the tenant is the reputed owner. This may apply to hire purchase goods even if the agreement has been successfully terminated by the distress. The order and disposition clause is borrowed from the old Bankruptcy Acts. It first appeared in 1623.³⁴ The policy behind the rule in a bankruptcy context was explained by Lord Hardwicke in *Ryall v. Rolle*:³⁵

It "... was to prevent traders from gaining a delusive credit from a false appearance of their circumstances, to the misleading and deceit of those who should trade with them, and the legislature thought they had done this by subjecting all things remaining in the possession of the bankrupt, to the creditors under the commission ...".³⁶

In applying the order and disposition clause to distress, Parliament was in effect warning third parties that if they allowed tenants to possess the third party's goods and to permit them to appear to be the owner of those goods, the goods would be subject to a landlord's distress.

The order and disposition clause appears to be of concern to anyone who hires out goods.³⁷ However, a recent Court of Appeal case suggests that such concern may be unwarranted. In *Salford Van Hire (Contracts) Ltd v. Bocholt Developments Ltd*,³⁸ a van which had been hired by the tenant company had been distrained. It was a three year old, plain white van without any markings on it identifying the owner. It had been specifically converted to the use of the company. Despite a very strong looking argument to

³³ See *Times Furnishing Co. Ltd v. Hutchings* [1938] 1 K.B. 775.

³⁴ Sections 10 and 11 of the Bankruptcy Act 1623 (21 Jac. 1 c. 19).

³⁵ [1749] 1 Atk. 165.

³⁶ *Ibid.* at 183.

³⁷ Although consumer hiring agreements are within s.4A of the 1908 Act, this part of the section has not been brought into force, which leaves hirers of goods free to claim the protection of s.1.

³⁸ [1995] C.L.C. 611.

the contrary, the court held that it was not in the company's reputed ownership.

The court took judicial notice that such hiring agreements were commonplace. In order to be in the company's reputed ownership the van would need to be in its possession in such circumstances that it "must"³⁹ belong to the tenant. As hiring agreements are so much a part of modern commercial life there could be no inference that the van "must" belong to the tenant. This very restrictive interpretation of the order and disposition clause would seem to cover all conditional sale, hire purchase and retention of title agreements. If this is the case, it will drastically affect the ability of a landlord when distraining commercial premises for the very reason that goods subject to such types of agreement are so common. If such goods are not within the order and disposition clause, (assuming the agreement has terminated bringing the goods *prima facie* within the protection of section 1 of the 1908 Act) a landlord will not be safe in distraining without making careful enquiries as to ownership of the assets on the premises.⁴⁰

In the latter part of the 20th century residential tenancies received extra protection. If the tenancy is a protected tenancy under the Rent Act 1977⁴¹ or an assured tenancy under the Housing Act 1988,⁴² the landlord must obtain a court order before levying distress. Landlords of other residential tenancies such as secure tenancies,⁴³ which would include most local authorities, may continue to distrain without judicial permission.

Privileged Goods

In addition to the above provisions both statute and case law have added further complexity to the law by limiting what goods are capable of being distrained. Some goods are absolutely privileged. A landlord who distrains such goods is guilty of an illegal distress. The following are examples of absolutely privileged goods:

- 1) tenant's fixtures⁴⁴;

³⁹ *Ibid.* at 620 *per* Hirst L.J.

⁴⁰ Enquiries as to ownership would have been appropriate in *Salford*; *ibid.* at 621.

⁴¹ Section 147.

⁴² Section 19.

⁴³ Under the Housing Act 1985.

⁴⁴ See, e.g. *Pitt v. Shew* [1821] 4 B. & Ald. 206.

- 2) wearing apparel and bedding⁴⁵;
- 3) tools of the tenant's trade⁴⁶;
- 4) items of public trade. This covers items "delivered to a person exercising a public trade, to be carried, wrought, worked up, or managed in the way of his trade . . .".⁴⁷ Examples of this category given in Halsbury are "a horse in a smith's shop, materials sent to a weaver, or cloth sent to a tailor . . .".⁴⁸ In terms of protecting the goods of third parties this privilege has been largely taken over by the protection afforded by the Law of Distress Amendment Act 1908;
- 5) perishable items which cannot be returned to the owner in the same state as when distrained⁴⁹;
- 6) things in actual use at the time of distress. In a modern setting it would seem likely that a shop full of televisions, video recorders and computers etc., if switched on to encourage customers to purchase them, would be regarded as things in actual use.⁵⁰

A landlord who commits an illegal distress may be liable in damages. The tenant may apply to the court to order up delivery of the goods under the Torts (Interference with Goods Act 1977).⁵¹ An aggrieved tenant is also entitled to rescue the goods before they are impounded⁵² (a self help counter remedy). The tenant will also have the right to replevy. The tenant will even be able to sue a purchaser in conversion as the distress is unlawful and void *ab initio* which prevents the landlord from giving a good title.⁵³

Other goods are given qualified privilege which means that they can only be distrained if there are no other non-privileged goods sufficient to satisfy the outstanding rent. Most examples of qualified privilege apply to agricultural tenancies.⁵⁴ A landlord

⁴⁵ Section 4 of the Law of Distress Amendment Act 1888 as amended by s.89 of the County Courts Act 1984 which itself is amended by s.15 of the Courts and Legal Services Act 1990.

⁴⁶ *Ibid.*

⁴⁷ Halsbury's *Laws of England* (4th ed., Vol. 13) distress at para. 231.

⁴⁸ *Ibid.*

⁴⁹ See, e.g. *Morley v. Pincombe* (1848) 2 Exch. 101—20 dead pigs.

⁵⁰ See, e.g. *Field v. Adames* (1840) 12 Ad. & El. 649—horse drawing a cart.

⁵¹ See generally (1978) 41 M.L.R. 713.

⁵² *Keen v. Priest* (1859) 4 H. & N. 236 at p. 241.

⁵³ *Mennie v. Blake* (1856) 6 E. & B. 842.

⁵⁴ See, e.g. *Simpson v. Hartopp* (1744) Willes 512—sheep and beasts which "gain" the land.

who acts in breach of qualified privilege risks being sued for excessive distress and being held liable in damages.

Procedural Complexities

As well as illegal and excessive distress a landlord may be guilty of an irregular distress. This is where, although the goods have been properly seized, the distrainor commits some subsequent unlawful act. An example of this would be proceeding to sell the goods after the tenant had tendered payment of the arrears and costs of the seizure. Under section 19 of the Distress for Rent Act 1737⁵⁵ such an irregularity does not make the distress void *ab initio* and the tenant is limited to a claim in damages. The distinction between illegal and irregular distress⁵⁶ has been described as "somewhat artificial"⁵⁷ and "the practical result is much confused".⁵⁸

A tenant who incorrectly believes a distress is illegal who then retrieves the goods after they are seized but before they are impounded, commits the tort of "rescous". This entitles the landlord to recover the damages to the value of treble the unpaid rent.⁵⁹ It is possible that rescous is also an indictable offence.⁶⁰ Once the goods are impounded, whether lawfully or not, they are in the custody of the law and cannot be retaken.⁶¹ A tenant who retrieves them after impounding is guilty of the indictable offence of "poundbreach" and is again liable civilly for treble damages.⁶² Although it was once common for the landlord to remove goods to a separate "pound", in recent times it is more common to take walking possession of the goods on the demised premises. It is not clear whether walking possession is a type of impounding or an alternative to it.⁶³ When a walking possession agreement is breached it is therefore unclear whether rescous or poundbreach has been committed.

There are many other rules of which a distrainor needs to be aware. Levying distress is not permitted on a Sunday.⁶⁴ It may

⁵⁵ 11 Geo. II c. 19.

⁵⁶ For further discussion of illegal and irregular distress see H. Edmund-Davies, *The Law of Distress for Rent and Rates* (Waterlow & Sons, London, 1931), pp. 77-87.

⁵⁷ Law Commission Landlord and Tenant Distress for Rent No. 194 (1991) at para. 2.69.

⁵⁸ *Ibid.* at para. 2.70.

⁵⁹ Section 3 of the Distress for Rent Act 1689.

⁶⁰ See Law Commission Working Paper No. 97 Distress for Rent (1986) at para. 4.32.

⁶¹ *Cotsworth v. Betison* (1696) 1 Ld. Raym. 104.

⁶² See Law Commission Working Paper No. 97 Distress for Rent (1986) at para. 4.32.

⁶³ No clear answer is to be found in *Abingdon Rural District Council v. O'Gorman* [1968] 2 Q.B. 811 although Russell L.J. at 827 believed it did amount to an impounding.

⁶⁴ *Werth v. London and Westminster Loan and Discount Co.* (1889) 5 T.L.R. 521.

only take place between sunrise and sunset.⁶⁵ The distrainer has a right to enter the demised premises but cannot force entry. Entry by opening a door in the normal way is permissible⁶⁶ but it is not clear whether entry by using a spare key is forcible entry or not.

Problems with Distress

Many criticisms have been levelled at distress and suggestions have been made to amend or abolish the whole doctrine.⁶⁷ As has been demonstrated, it has become an extremely technical remedy. In order to levy distress according to the law, a landlord or appointed bailiff⁶⁸ would ideally have memorised all the detailed provisions listed in nearly 100 pages of Halsbury.⁶⁹ The general rule that all the goods on the demised premises may be distrained is subject to so many exceptions that uncertainty haunts every distraint.

In many instances distress can be levied without judicial authority and this is of concern because there is evidence of abuse of position by distraining bailiffs.⁷⁰ Although there is a duty to sell distrained goods at the best possible price, second hand goods in a "fire sale" rarely achieve a price commensurate with the value of the goods to the tenant.⁷¹

A tenant suffering a distress is in a far worse position than a debtor suffering judicial debt enforcement. The tenant has no real opportunity to prevent the distress occurring even though it may be proceeding illegally. Any remedy the tenant has will normally only be exercised after the distress has already been levied.⁷² Even if the tenant succeeds in an action for damages, this will often be

⁶⁵ *Tutton v. Darke* (1860) 5 H. & N. 647.

⁶⁶ *Ryan v. Shilcock* (1851) 7 Exch. 72.

⁶⁷ See, e.g. Report of the Committee on Bankruptcy Law and Deeds of Arrangement Law Amendment Cmnd. 221 (1957) Blagden Committee, Law Commission Landlord and Tenant Interim Report on Distress for Rent (1966), Report of the Committee on the Enforcement of Judgment Debts Cmnd. 3909 (1969) Payne Committee, Report of the Review Committee on Insolvency Law and Practice Cmnd. 8558 (1982) Cork Committee, Law Commission Working Paper No. 97, *Distress for Rent* (1986), Law Commission Landlord and Tenant Distress for Rent No. 194 (1991).

⁶⁸ The Law of Distress Amendment Act 1888 introduced the requirement that bailiffs employed to distrain on behalf of a landlord have to be licensed by the court.

⁶⁹ *Halsbury's Laws of England* (4th ed., Vol 13) distress paras 201-396.

⁷⁰ Law Commission Working Paper No. 97, paras 2.7-2.11, Loveland, "Distress for Rent: An Archaic Remedy?" (1990) 17 J. of Law & Soc. 363 at 366-7 and Alison Green *Undue Distress: CAB Clients' Experience of Bailiffs* NACAB, May 2000.

⁷¹ Law Commission No. 194 at para. 3.16.

⁷² Equitable set-off is available against a claim to levy distress and may allow for injunctive relief (*Eller v. Grovecrest Investments Ltd* [1995] Q.B. 272).

some time after the distress is complete. If the tenant carries on business at the demised premises the majority of stock and equipment needed in the trade may have been seized and sold and a judicial remedy some time later may be too late to save the business.

Where the distress is illegal the right to replevy is frequently illusory as it requires the complainant to provide security for all the alleged unpaid rent prior to any hearing of the merits. If the tenant has such security available, it is unlikely that the distress would have occurred in the first place.

The impact upon third parties whose goods are seized is extremely difficult to justify. The privileges attached to third party goods are subject to exceptions which appear to lack any logical basis and are largely inappropriate in the modern world. There is no requirement to notify the third party and so the relevant goods can be sold to satisfy the rent demand before the third party even discovers what is happening.

Frequently a defaulting tenant will, in addition to not paying the landlord, have failed to pay other creditors. The remedy of distress discriminates against other creditors of the tenant by giving the landlord the means to achieve priority over those other creditors. Distress is seen at its most effective when the tenant is insolvent as it can give the landlord the ability to jump the queue of unsecured and in some circumstances even secured creditors.

It is outside the scope of this article to consider the operation of distress in the procedures under Insolvency Act 1986.⁷³ Professor Goode has stated that the fundamental principle of insolvency law "is that of *pari passu* distribution, for creditors participating in the common pool in proportion to the size of their admitted claims".⁷⁴ No unsecured creditor should be given priority over other unsecured creditors. Perhaps not surprisingly for a remedy which has developed in an entirely *ad hoc* manner, the operation of distress in an insolvency context is arbitrary. There are no real restrictions on levying distress where a tenant is in bankruptcy⁷⁵ or receivership.⁷⁶ This permits the landlord to obtain payment ahead of unsecured and even secured creditors. Different rules apply for compulsory liquidation⁷⁷ compared with voluntary

⁷³ See Walton "The landlord, his distress, the insolvent tenant and the stranger" (2000) 16 I.L. & P. 47 and Chapter 3 of the excellent McLoughlin, *Commercial Leases and Insolvency* (2nd ed., Butterworths, London, 1996).

⁷⁴ Goode, *Principles of Corporate Insolvency Law* (Sweet & Maxwell, London, 1990), p. 59.

⁷⁵ Section 347 of the Insolvency Act 1986.

⁷⁶ *Purcell v. Public Curator of Queensland* (1922) 31 C.L.R. 220.

⁷⁷ Sections 126, 128 and 130 of the Insolvency Act 1986.

liquidation.⁷⁸ Distress is prevented where a company is in administration and considering a company voluntary arrangement⁷⁹ but not where an individual has the benefit of an interim order and is considering an individual voluntary arrangement.⁸⁰ There appears to be no convincing reason why distress should be permitted once any formal insolvency proceeding has commenced.⁸¹

Other Common Law Jurisdictions

Most of the common law world has already abolished or restricted the use of distress. Many American states refused to allow distraints on the ground that they are founded on the feudal system.⁸² Those American States that did have distress have generally abolished or restricted its operation.⁸³ New Zealand has retained it notwithstanding recommendations that it should be completely abolished.⁸⁴ The Australian states of New South Wales (as long ago as 1930),⁸⁵ Western Australia in 1936,⁸⁶ Victoria in 1958⁸⁷ and Queensland in 1974⁸⁸ have all wholly abolished the remedy. In South Australia the remedy has recently been restricted to commercial tenancies.⁸⁹ Of all the Australian states only Tasmania has left it untouched, but this seems more by accident than design. As part of a temporary rent restriction programme in 1949 distress was abolished for residential tenancies. Once the time limit on the programme expired, the previous law, including the remedy of distress, became effective again.⁹⁰ It seems only a matter of time before distress is completely abolished in Australia.⁹¹

⁷⁸ Section 112 *ibid.*

⁷⁹ Sections 10 and 11 *ibid.*

⁸⁰ *McMullen & Sons Ltd v. Cerrone* [1994] B.C.C. 25.

⁸¹ As was recommended by the Cork Committee at para. 1667.

⁸² See *Woodfall on Landlord and Tenant* (22nd ed., Sweet & Maxwell, Stevens & Sons, London, 1928) notes to p. 528.

⁸³ See e.g. Osowski "Alaska distress law in the commercial context: ancient relic or functional remedy?" (1993) 10 *Alaska Law Review* at 33-63.

⁸⁴ See the New Zealand Property Law and Equity Reform Committee Final Report on Legislation relating to Landlord and Tenant (1986).

⁸⁵ Landlord and Tenant Amendment (Distress Abolition) Act 1930.

⁸⁶ Distress for Rent Abolition Act 1936.

⁸⁷ Landlord and Tenant Act 1958.

⁸⁸ Property Law Act 1974.

⁸⁹ Residential Tenancies Act 1995.

⁹⁰ See Law Commission Landlord and Tenant Distress for Rent No. 194 (1991) at para. 3.31.

⁹¹ Guthleben "Distress for Rent" (1995) 17 *Adelaide Law Review* 301.

In Northern Ireland distress has also been wholly abolished.⁹² The main difference between the Australian approach to abolition and that of Northern Ireland is that the Australians have tended to abolish the remedy with a single simple isolated provision, whereas in Northern Ireland distress was viewed along with other debt enforcement mechanisms and the whole system was overhauled together. The abolition of distress was seen as a necessary consequence of making enforcement a fairer and simpler system. There appear to be no hidden consequences of abolition. The landlord is merely reduced to the same position as any other creditor, albeit usually retaining the power to forfeit the lease or chase prior assignees of the lease.⁹³

Reforms

In England and Wales the Law Commission in its Interim Report on Distress for Rent in 1966 suggested that distress should not be abolished until the introduction of an effective method of debt enforcement generally. It consequently recommended nothing should be done until the Payne Committee⁹⁴ had reported. The Payne Committee recommended abolition of distress as (i) it would be almost impossible to amend satisfactorily such a complex doctrine and (ii) the retention of distress would be inconsistent with the Committee's proposals for an improved system of debt recovery. The Payne recommendations were not put into effect. The Law Commission returned to distress again in 1986⁹⁵ and reported in 1991.⁹⁶ Again it recommended abolition but only at a time in the future when landlords could be assured of "an efficient means of enforcing payment of rent arrears, but the remedies [in existence at the time] fall short of the ideal, primarily because the court machinery within which they operate is overburdened and no longer permits them to function properly".⁹⁷ It seems perhaps over protective of landlords who may have other remedies in addition to distress, not to abolish

⁹² Abolished by the Judgments (Enforcement) Act (NI) 1969 following the recommendations of the Anderson Report (the Report of the Joint Working Party on the Enforcement of Judgments, Orders and Decrees of the Courts in Northern Ireland 1965)—the Northern Irish equivalent of the Payne Committee.

⁹³ See e.g. Hunter, *Northern Ireland Bankruptcy Law and Practice* (SLS Legal Publications [NI], Belfast, 1984), p. 257.

⁹⁴ Report of the Committee on the Enforcement of Judgment Debts (1969) Cmnd. 3909.

⁹⁵ Law Commission Working Paper No. 97 Distress for Rent (1986).

⁹⁶ Law Commission Landlord and Tenant Distress for Rent No. 194 (1991).

⁹⁷ *Ibid.* at paras 5.22.

the remedy and place landlords' claims for unpaid rent on the same footing as claims by other unsecured creditors.

The Payne recommendations were not adopted in 1969, but the current Lord Chancellor, following on from the Woolf reforms,⁹⁸ has put into effect a *Review of Enforcement of Civil Court Judgments*.⁹⁹ It may be that England and Wales will shortly follow the example of Northern Ireland and completely overhaul the system of debt enforcement. If the system of debt recovery is improved so that the courts did provide "an effective system" for landlord enforcement, why not follow the example of some of our antipodean colleagues and simply abolish distress? Under Woolf the conduct of litigation is to a large extent taken away from the parties and given to the court. The self help remedy of distress is even more anomalous in this context as it retains control firmly in the hands of the landlord.

Human Rights Act 1998

The Human Rights Act 1998¹ incorporates into U.K. law some of the rights granted to persons under the European Convention on Human Rights ("Convention"). Although it has previously been possible for an individual to petition the European Court of Human Rights in Strasbourg directly,² until the passing of the Act, Convention rights have not been directly enforceable in U.K. domestic courts. It is inappropriate here to attempt more than a bare outline of the operation of the Act and some of the Convention rights which may be relevant in considering how distress stands under the new law.³

In general, domestic courts will have to decide all cases based upon statute or common law in a manner which is compatible

⁹⁸ Civil Procedure Rules 1998.

⁹⁹ The Lord Chancellor's Department has to date issued four Consultation Papers: *Enforcement Review: How can Enforcement of Civil Court Judgments be made more effective?* CP June 1, 1998; *Enforcement Review: Key Principles for a New System of Enforcement in the Civil Courts*, CP May 2, 1999; *Enforcement Review: Attachment of earnings orders, charging orders and garnishee orders*, CP October 3, 1999; *Enforcement Review: Warrants and Writs, Oral Examinations and Judgment Summonses*, January 2000 and has now reported on the review process thus far: *Enforcement Review: Report of the First Phase of the Enforcement Review*, July 2000.

¹ In force October 2, 2000.

² Even prior to the Act coming into force it has been possible in domestic courts to base arguments on the Convention see Hunt, *Using Human Rights Law in English Courts* (Hart Publishing, London, 1997).

³ For a more in depth account of how the Act is likely to operate generally see Wadham and Mountfield, *Introduction to the Human Rights Act 1998* (Blackstone, London, 1999).

with Convention rights.⁴ Any question of statutory interpretation must be resolved consistently with Convention rights wherever this is possible.⁵ In making decisions the courts must take into account relevant case law of the European Court of Human Rights.⁶ This last point may suggest to a U.K. lawyer that the Strasbourg Court's decisions will be binding precedents. This may not be so for two reasons:

- i) Section 2 of the Act requires the court to take account of the European Court's decisions but does not state that they are binding. It may be that the United Kingdom courts will in time develop its own human rights jurisprudence, albeit one with European influences.
- ii) The European Court has interpreted the Convention in such a way as to give the signatory state in question a margin of appreciation when it considers the state's domestic law. This means that the state is permitted some flexibility in how it decides it is best to give effect to the Convention. For example in *James v. United Kingdom*⁷ where the validity of a tenant's right to purchase the freehold under the Leasehold Reform Act 1967 was considered under Article 1, the Court allowed the United Kingdom a wide margin of appreciation. The case concerned the United Kingdom's social and economic policy and so a wide margin was deemed appropriate. The margin of appreciation varies from Convention right to right and from case to case. The Act does not expressly include this margin of appreciation and so the United Kingdom courts appear to have a discretion whether or not to adopt this approach.⁸

If a claim is made against a public body the Act creates directly enforceable rights for the claimant. A public body in this context would include local authorities. Local authority tenants will often hold under secure tenancies which would not prevent the local authority landlord from distraining without judicial permission. Under section 6 it is unlawful for a public body to act in a manner incompatible with a Convention right. Section 7 allows an individual to sue the public body and to enforce directly the

⁴ Section 6(1)–(3).

⁵ Section 3.

⁶ Section 2(1). Account must also be taken of decisions of the Commission on Human Rights and the Committee of Ministers.

⁷ (1986) 8 E.H.R.R. 123.

⁸ Wadham and Mountfield, *Introduction to the Human Rights Act 1998* (Blackstone, London, 1999), p. 18.

Convention right which has been infringed. If distress is incompatible with a Convention right, a local authority tenant suffering distress may wish to use the Act to enforce the Convention right in the local court.

If a claim is between two parties acting in only a private capacity, the Act does not permit Convention rights to be enforced directly. This would include the common case of a private landlord levying distress. The tenant will not be able to enforce Convention rights directly. The Act will have an indirect effect in that the court, as a public body itself, must apply common law principles compatibly with the Convention and must, if possible, interpret statutes so as to conform with the Convention. If a statute is not capable of an interpretation which is compatible with Convention rights, the court has no power to declare it void and ignore it. The court must still apply the statute. If this happens the court does have the power to issue a "declaration of incompatibility", and Parliament can subsequently use a new fast-track procedure to pass legislation to remedy the problem.

Distress may be seen as breaching rights given under Article 6 and Article 1 of the First Protocol of the Convention.⁹

Article 6

The first sentence of Article 6(1) states:

"In the determination of his civil rights and obligations . . . everyone is entitled to a fair and public hearing within a reasonable time by an independent and impartial tribunal established by law."

A tenant who suffers a distress does not usually have any right to challenge the landlord's claim prior to the levy. There is no right to a hearing prior to the levy. If the distress was illegal, irregular or excessive the tenant will have a right to a hearing to determine the parties' respective rights but this will be after the levy. If the distress is lawful under common law and statutory rules, there is no right whatsoever to a court hearing. In this latter situation if rent is outstanding, the landlord can in effect act as judge and debt enforcer.

The position of a third party under Article 6 is potentially much stronger. If aware of a distress involving his or her goods, the third party may have protection by serving a notice under the

⁹ There may also be an argument, in the context of residential leases, that distress offends Article 8 which states that everyone "has the right to respect for his private life, his home . . .". "Home" has been interpreted as including the office of a professional in *Niemetz v. Germany* (1992) 16 E.H.R.R. 97.

Law of Distress Amendment Act 1908. It may be that the goods do not fall within the Act's protection or that the third party has no knowledge of the distress at all. If this is the case the landlord may sell the goods lawfully and the third party loses out. As there is no obligation to inform the third party of the distress there is clearly no right to a trial to contest the distress.

It is submitted that, depending upon the individual circumstances, both a tenant and more convincingly a third party, would have a strong argument that the statutory provisions under which the landlord has distrained were incompatible with Article 6. Although the 1908 Act gives some rights to the third party it allows others to prevent the enforcement of those rights by not notifying the third party that the goods are imperilled. If the landlord is, for example, a local authority, the Human Rights Act would give directly enforceable rights to the aggrieved party. If the distrainer was a private landlord a claim could lead to a declaration of incompatibility.

Article 1 of the First Protocol

Article 1 states:

"Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law.

The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties."¹⁰

The protection under Article 1 applies except where the public interest demands it should not. In *James v. United Kingdom*¹¹ it was decided that the Leasehold Reform Act 1967 did deprive the petitioner of its possessions. However, it did not breach Article 1 as the compulsory transfer of property in such circumstances could be a legitimate means of promoting the public interest. It was crucial to the decision of the Court that compensation had been paid for the freehold. The compensation was not the full market value, but because it was a reasonable amount, the deprivation of possessions was not seen as so serious as to amount to a breach of Article 1. The loss to the freeholder was

¹⁰ The second sentence of Article 1 deals with "control" of the use of property not deprivation and would therefore appear not to cover distress.

¹¹ (1986) 8 E.H.R.R. 123.

not disproportionate when the overall public benefit was factored in.¹²

Clearly distress deprives a person of his or her possessions. A tenant who suffers a distress may be seen as acquiring some form of compensation in that the proceeds of sale go to paying the rent owing. It could also be argued that it is in the public interest to allow landlord's the right to obtain payment of rent by these means.

A third party whose goods are distrained has been deprived of possessions and may have no remedy against anyone. Certainly no remedy lies against the landlord if the distress is lawful. There would appear to be no right to any compensation in any form. It would be very difficult for a landlord to claim that it is in the public interest to allow distraint of a third party's goods. It is in the interest of the landlord only.

It is submitted that a third party whose goods are distrained and who cannot rely upon the protections of the 1908 Act could rely upon Article 1. If the landlord is a public authority the right will be directly enforceable. If the distrainer is a private landlord, the court may attempt to interpret the law relating to distress in a manner compatible with Article 1. If, as seems likely, it fails to achieve this, the consequence may be a declaration of incompatibility.

As part of the Lord Chancellor's *Review of Enforcement of Civil Court Judgments*, Professor Beatson has carried out an independent review of the law relating to bailiffs.¹³ One of Professor Beatson's conclusions is that there is a "real risk"¹⁴ that certain aspects of distress breach the Human Rights Act and he makes a number of recommendations¹⁵ to minimise the risk of a challenge under the Act.¹⁶ The Lord Chancellor is likely to respond to these recommendations by the end of the year.

Conclusions

Distress is deeply rooted in antiquity and all the reasons for its existence, apart from giving the landlord a convenient means of obtaining an unfair priority over other creditors, are entirely

¹² See also *Holy Monasteries v. Greece* (1994) 20 E.H.R.R. 1.

¹³ *Independent Review of Bailiff Law*, June 2000 available at <http://www.open.gov.uk/lcd/enforcement/beatson.pdf>.

¹⁴ *Ibid.* at para. 2.26.

¹⁵ *Ibid.* at para. 2.27.

¹⁶ Professor Beatson's terms of reference assume that some system of enforcement by distress will be retained and so his report does not consider outright abolition as an option.

historical. Amendments have been made to the law on an entirely *ad hoc* basis over a period of centuries. Additions or changes to the law have generally remained in place as new provisions have been added, thus creating ever greater complexity. It has not evolved into a modern remedy. It is an out of date doctrine full of practical uncertainties. Its effect on third parties is particularly arbitrary and unfair. The abolition of distress has been recommended frequently. Other jurisdictions have managed to rid themselves of its blight, yet the United Kingdom Parliament has refused to act no matter how often called upon to do so. At the beginning of the last millennium distress was considered as attractive as fresh spring greens but today appears to have all the allure of rotten old cabbage. It is past its sell by date and it is hoped that the Human Rights Act 1998 will finally force Parliament to take it off the shelf of remedies available to landlords.

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Execution Creditors— (almost) the Last Rights in Insolvency

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Abstract The Lord Chancellor's Department is improving methods of enforcing judgments and Parliament is revamping insolvency law. Little, if any, analysis appears to have been made as to how enforcement operates in formal insolvency procedures. The case law dealing with whether or not an execution creditor becomes a secured creditor is a maze if not a minefield. The issue is of paramount importance when the judgment debtor is insolvent. Depending upon which insolvency procedure is in operation and which type of execution has been chosen, the creditor may be either in a very strong or a pitifully weak position.

I. Introduction

The most fundamental policy of insolvency law is that creditors should be treated equally.¹ This *pari passu* rule is in practice subject to a great many exceptions. An unsecured creditor will often see no return on a debt owed by an insolvent debtor. Creditors with security will have priority, as will, to a limited extent, employees of the insolvent debtor in relation to their preferential debts.² Any creditor with the benefit of a retention of title clause under a contract of supply or a creditor under a hire purchase or conditional sale agreement will have title to the goods supplied and can repossess such goods. Landlords owed rent by an insolvent debtor have the benefit of the self-help remedy of distress which, subject to exceptions, *prima facie*

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1 R. Goode, *Principles of Corporate Insolvency Law*, 2nd edn (Sweet and Maxwell: London, 1997) 141; Report of the Insolvency Law Review Committee, *Insolvency Law and Practice*, Cmnd 8558 (1982) ('the Cork Report') para. 233; V. Finch, 'Directors' Duties: Insolvency and the Unsecured Creditor' in A. Clarke (ed.), *Current Issues in Insolvency Law* (Stevens: London, 1991) 87; A. Keay and M. Murray, *Insolvency: Personal and Corporate Law and Practice*, 4th edn (Law Book Co: Sydney, 2002) 26 and 293.

2 Insolvency Act 1986, s. 386 and Sch. 6. Section 251 of the Enterprise Act 2002 abolishes the Crown's preferential status, although employees' limited preferential rights remain. For the background to preferential debts and for a discussion as to whether they should be abolished, see A. Keay and P. Walton, 'The Preferential Debts Regime in Liquidation Law: In the Public Interest?' (1999) 3 *Company, Financial and Insolvency Law Review* 84.

enables landlords to seize and sell any goods on the tenanted premises regardless of their true ownership.³ In the feeding frenzy which follows a debtor's insolvency unsecured creditors frequently struggle to get a look in.

Although the Woolf reforms⁴ have now been brought into effect, access to justice is not yet complete. The reforms deal with proceedings leading up to judgment only. Provisions dealing with enforcement of judgments remain largely as before although some changes to procedure and terminology have been made recently.⁵ The need for a complete revamp of enforcement of judgments has long been recognized⁶ and is currently the subject of a long running review by the Lord Chancellor.⁷

The purpose of this article is to consider generally how unsecured creditors can improve their chances of being paid by obtaining judgment against their debtor and enforcing that judgment by way of execution. It will be seen that there are a number of different ways of executing a judgment depending upon the type of assets owned by the judgment debtor. Depending upon the context of the judgment creditors' claim they may or may not be viewed as secured creditors. If they are viewed as secured, they will be able to leapfrog over at least some of the debtor's other creditors. It is for the judgment creditor to decide how best to enforce the judgment.⁸

This article will consider the effect of execution on the debtor's property and also the priority position of the execution creditor in any formal insolvency procedure which the debtor may enter. Although such a scenario is extremely common, the applicable law and procedure are not entirely straightforward and, apart from the ongoing review by the Lord Chancellor, have not been the subject of recent

3 See e.g. P. Walton, 'Landlord's Distress—Past Its Sell By Date?' [2000] Conv 508 and *id.*, 'The Landlord, his Distress, the Insolvent Tenant and the Stranger' (2000) 16 *Insolvency Law and Practice* 47.

4 Civil Procedure Rules 1998 (SI 1998/3132) 'the CPR'.

5 Provisions dealing with enforcement in the High Court, formerly contained in the Rules of the Supreme Court (SI 1965/1776) 'the RSC', are now found in Parts 70–73 and Sch. 1 to the CPR. On the coming into force of the CPR the old RSC rules were transferred intact into Sch. 1. These provisions have been partly amended by the Civil Procedure (Amendment No. 4) Rules 2001 (SI 2001/2792) which came into force on 25 March 2002. Although changes have been made to procedure and terminology there appears to be no intention to change the legal effect of the amended methods of enforcement.

6 *Report of the Committee on the Enforcement of Judgment Debts*, Cmnd 3909 (1969) ('the Payne Committee').

7 The Lord Chancellor's Department, *inter alia*, issued four Consultation Papers: *Enforcement Review: How can Enforcement of Civil Court Judgments be made more effective?* CP 1, June 1998; *Enforcement Review: Key Principles for a New System of Enforcement in the Civil Courts*, CP 2, May 1999; *Enforcement Review: Attachment of Earnings Orders, Charging Orders and Garnishee Orders*, CP 3, October 1999; *Enforcement Review: Warrants and Writs, Oral Examinations and Judgment Summonses*, January 2000 and has reported on the review process thus far: *Enforcement Review: Report of the First Phase of the Enforcement Review*, July 2000.

8 CPR r. 70.2.

commentary.⁹ It will be seen that execution creditors often find themselves in a difficult position. No matter how diligent they are in obtaining and executing their judgment, they may find that other creditors still have priority, or that their execution is halted at the final hurdle and that all they have achieved is to throw good money after bad.

II. Types of Execution

Before considering the position of an execution creditor where the debtor has entered a formal insolvency procedure, it is first necessary to consider the various enforcement methods available to the creditor. In considering the principal methods of execution it is intended to analyse the legal rights which each method gives to the creditor.

Execution can be taken to mean 'the process for enforcing or giving effect to the judgment of the court'.¹⁰ A judgment for the payment of money may be enforced in the High Court by a writ of *fiery facias*,¹¹ a third party debt order,¹² a charging order¹³ or the appointment of a receiver.¹⁴ There is also the comparatively rare possibility of sequestration under the court's contempt jurisdiction.¹⁵ The creditor may also have the right to have the judgment enforced in the county court¹⁶ or rely upon some other rights such as petitioning for the bankruptcy¹⁷ (if the debtor is an individual) or winding up¹⁸ (if a company) of the judgment debtor.¹⁹

A judgment for the giving of possession of land may be enforced by a writ of possession.²⁰ A judgment for the delivery of goods may be enforced by a writ of specific delivery.²¹

9 But see the excellent D. Hare and D. Milman, 'Debenture holders and judgment creditors—problems of priority' [1982] *LMCLQ* 57; R. Calnan, 'Priorities Between Execution Creditors and Floating Chargees' (1982-3) 10 *NZULR* 111; and P. Blanchard, 'The "Security" of an Execution Creditor' (1982-3) 10 *NZULR* 332.

10 *Re Overseas Aviation Engineering (GB) Ltd* [1963] Ch 24 at 39 per Lord Denning MR. See also *Blackman v Fysh* [1892] 3 Ch 209 at 217 per Kekewich J.

11 See CPR Sch. 1 Ord. 47.

12 CPR Part 72.

13 CPR Part 73.

14 See CPR Part 69 brought into force by the Civil Procedure (Amendment) Rules 2002 (SI 2002/2058) which revoke CPR Sch. 1 Ord. 51. If the judgment or order is to do or restrain from doing any act, which would include a judgment which specifies a time for payment of the money to a person (very unusual in practice), it may be enforced by order of committal or writ of sequestration (CPR Sch. 1 Ord. 45, rr. 5, 6 and 7).

15 See e.g. *Pratt v Inman* (1889) 43 Ch D 175.

16 See County Courts Act 1984, s. 105(1) under which a High Court judgment may be enforced in the county court under s. 85 as if it were a judgment of that court.

17 Insolvency Act 1986, s. 264.

18 *Ibid.* s. 124.

19 Enforcement may also be possible under the Debtors Acts 1869 and 1878 subject to the Administration of Justice Act 1970, s. 11.

20 CPR Sch. 1 Ord. 45 r. 3.

21 CPR Sch. 1 Ord. 45 r. 4(1)(a). A judgment for the delivery of any goods or payment of their assessed value in the alternative may be enforced by a writ of delivery to recover the goods or their assessed value or, with leave of the court, a writ of specific delivery.

For the purposes of this article it is intended to concentrate upon the modes of execution most likely to be sought by a commercial creditor, namely the writ of *fiери facias*, third party debt orders and charging orders. As will be seen, the legal effect of charging orders is relatively certain. The same cannot safely be asserted in relation to third party debt orders or the writ of *fiери facias*.

i. Third Party Debt Orders (previously Garnishee Proceedings²²)

In third party debt proceedings an interim order is served on a third party who is a debtor of the judgment debtor. The third party is frequently a bank with whom the judgment debtor holds an account in credit and the intention is to require the bank to pay the execution creditor, rather than the judgment debtor, the money held in the account. The procedure to obtain a third party debt order is a two-stage process.²³ An application for an interim third party debt order is made without notice. No hearing is held.²⁴ The interim order directs the third party not to make any payment to the judgment debtor which reduces the amount owed to the judgment debtor to less than the amount specified in the order. The interim order is binding upon the third party when it is served.²⁵

A return date is set for a hearing to consider whether or not to make the order final. This hearing is the second stage of the process. Unless there are grounds for objecting to the order it will be made final. The grounds upon which such objection may be made include the third party claiming a right of set-off or some other party claiming some prior right to the money. If the order is made final it becomes enforceable against the third party as an order to pay money,²⁶ and can thereafter be enforced against the third party.

Effect of Third Party Debt Orders

Under the previous enforcement regime of garnishee proceedings, the equivalent of the interim order, the garnishee order *nisi*, was expressly stated to bind the debt as from the service of the order on the garnishee:

Such an order shall bind in the hands of the garnishee as from the service of the order on him any debt specified in the order or so much thereof as may be so specified.²⁷

22 On 25 March 2002 garnishee proceedings were abolished and replaced by third party debt orders by the Civil Procedure (Amendment No. 4) Rules 2001 (SI 2001/2792) by the introduction of CPR Part 72.

23 Similar to the procedure for a garnishee order which it replaces. The former procedure to obtain a garnishee order was contained in RSC Ord. 49.

24 CPR r. 72.4(1).

25 CPR r. 72.4(4).

26 CPR r. 72.9(1).

27 RSC Ord. 49 r.3(2).

If the garnishee order were made absolute, execution could thereafter issue against the garnishee's own property.²⁸ It was the order *nisi* though which created an equitable charge over the debt.²⁹ The courts, despite some careless phrasing at times,³⁰ were consistent in deciding that a garnishee order *nisi* gave rise to an equitable charge over the debt in favour of the judgment creditor upon service of the order *nisi* on the garnishee.³¹ The debt became subject to the charge but was not transferred to the judgment creditor.³²

Under the new regime of third party debt orders there is no specific mention of the debt being bound by service of the interim order. There is a statement that the interim order 'becomes binding on a third party when it is served on him'³³ but not that it is binding upon the actual debt. It is clearly binding personally upon the third party who is required to retain enough of the debt to satisfy the judgment and costs of the enforcement but this does not amount to the creation of any interest by way of charge or otherwise over the debt itself in favour of the judgment creditor. The upshot of this is that a third party debt order does not constitute the execution creditor a secured creditor. The rights of the execution creditor are *in personam* and not *in rem*.

It is clear from the Lord Chancellor's *Review of Enforcement of Civil Court Judgments*³⁴ that although certain changes were intended to this form of execution, there was no intention to affect the secured status of the creditor following service of the interim (previously *nisi*) order.³⁵ There is no doubt that the Lord Chancellor has the power under the Civil Procedure Act 1997³⁶ to amend the Civil Procedure

28 RSC Ord. 49 r.4.

29 *Cairney v Back* [1906] 2 KB 746 at 750 per Walton J.

30 See the criticism by D. Hare and D. Milman, above n. 9 at 62 of Farwell LJ's dictum in *Galbraith v Grimshaw and Baxter* [1910] 1 KB 339 at 343.

31 See e.g. Lindley LJ in *Rogers v Whiteley* (1889) 23 QBD 236 at 238 who seems to use the terms 'garnishee order' and 'charging order' as interchangeable. See also e.g. *Emanuel v Bridger* (1874) LR 9 QB 286; *Re Stanhope Silkstone Collieries Co* (1879) 11 ChD 160; *Re National United Investment Corp'n* [1901] 1 Ch 950; *Galbraith v Grimshaw and Baxter* [1910] 1 KB 339, affd. [1910] AC 508.

32 *Chatterton v Watney* (1881) 17 ChD 259. The statement by James LJ in *ex p. Joselyne* (1878) 8 ChD 327 at 330 to the effect that property in the debt is transferred is not to be taken literally: *Norton v Yates* [1906] 1 KB 112 at 120 per Warrington J. See also *Re Combined Weighing and Advertising Co* (1889) 43 ChD 99.

33 CPR r. 72.4(4).

34 *Enforcement Review: Report of the First Phase of the Enforcement Review*, July 2000, Section 6 which led to the changes made by the Civil Procedure (Amendment No. 4) Rules 2001 (SI 2001/2792).

35 It is on the face of it a major break with the past. The origins of garnishee proceedings are somewhat ancient (see e.g. *Robbins v Standard* (1667) 1 Sid 327; 82 ER 1136). Initial common law application was extended to all courts after the Judicature Act 1875 when the garnishee provisions of the Common Law Procedure Act 1854 were incorporated into the RSC 1875 Ord. XLV r. 2. Until the recent amendment the provisions have always stated that the debt is bound by the order.

36 Sections 1–4 and Sch. 1.

Rules by statutory instrument through the output of the Rules Committee and so the amendment is valid.³⁷ It remains to be seen how the courts will interpret this apparent alteration. Due to the clear change in wording it is submitted that the only course open to the courts is to hold that the creditor at no time becomes a secured creditor over the debt owed by the third party. Although there may be rights enforceable personally against the third party, these do not amount to a right *in rem* over the debt itself. As will be demonstrated later, this may have consequences for the execution creditor in the event of the insolvency of the judgment debtor.

ii. Charging Orders

A charging order is defined by section 1(1) of the Charging Orders Act 1979 as an order 'imposing on any such property of the debtor as may be specified in the order a charge for securing payment of any money due or to become due under [a] judgment or order'. It may be used by a judgment creditor to obtain a charge over the judgment debtor's land, stocks and shares, beneficial interest under a trust or over money held in court for the debtor.³⁸ The order secures the debt but in itself does not produce any money. The procedure is similar to that involved in third party debt proceedings in that there is a two-stage process.³⁹ The first stage is to obtain an interim charging order (formerly a charging order *nisi*) without a hearing. The order will subsequently be made final unless the debtor (or other interested party) can show cause as to why it should not.⁴⁰ The creditor can enforce the charge by applying to the court for an order of sale.⁴¹

If the order is over shares, the creditor may apply to the court for a 'stop order'⁴² on the company in question to prevent any transfer of the shares occurring or a 'stop notice'⁴³ which prevents any such transfer without the company first giving the creditor notice of the proposed transfer. If the order is over land, in the period prior to an enforced sale the creditor can protect the charging order from a bona fide purchaser for value acquiring an unencumbered title, by registration under the Land Charges Act 1972 or by registering a notice or caution at the Land Registry.⁴⁴

37 *Ibid.*

38 Charging Orders Act 1979, s. 2(2).

39 The procedure was amended at the same time as garnishee proceedings were replaced by third party debt orders by the Civil Procedure (Amendment No. 4) Rules 2001 (SI 2001/2792).

40 CPR r. 73.8 and see Charging Orders Act 1979, s. 3(4).

41 By separate proceedings under CPR Part 8. See also CPR r. 73.10.

42 CPR r. 73.12.

43 CPR r. 73.17.

44 Charging Orders Act 1979, s. 3(2) and (3).

Effect of a Charging Order

There is no doubt that the interim charging order takes effect as an immediate equitable charge on the assets.⁴⁵ The recent changes to the Civil Procedure Rules appear to make no difference to this rule.

iii. Writ of Fieri Facias

The writ of *fi. fa.*⁴⁶ (commonly abbreviated to *fi. fa.*) may be used to execute a judgment or order for the payment of money or costs. The Lord Chancellor's *Review of Enforcement* has thus far made no changes to this form of execution. The writ of *fi. fa.* may issue immediately upon payment becoming due, which with a judgment in the ordinary form will mean immediately the judgment is entered. There will ordinarily be no need to serve notice of the judgment or the judgment itself on the debtor prior to the writ being issued.⁴⁷

The writ of *fi. fa.* is in the form of a royal direction addressed to the sheriff⁴⁸ of the county (or bailiwick) in which the debtor's goods are situate, to seize and sell such goods⁴⁹ of the debtor within the county as may be sufficient to satisfy the judgment, interest upon the judgment (which begins to run when judgment is entered) and the costs of the execution itself. The writ also instructs the sheriff to pay the amount levied to the judgment creditor less his own costs and fees.⁵⁰ It is the duty of the sheriff in executing the *fi. fa.* to take possession of all the goods of the judgment debtor within his bailiwick or at least sufficient to satisfy the execution.⁵¹ The sheriff owes a duty to the execution creditor to seize the debtor's goods at once.⁵² Upon the sale

45 See *ibid.* s. 3(4), CPR r. 73.4(2) and *Coutts and Co v Clarke* [2002] EWCA Cir. 943.

46 CPR Sch. 1 Ord. 47.

47 *Land Credit Company of Ireland v Fermoy* (1870) LR 5 Ch 323.

48 To whom the writ should be delivered. It is now possible to use the simpler expedient of delivering the writ to the Sheriffs Lodgement Centre.

49 At common law all goods and chattels of the judgment debtor could be seized and sold. This was extended by the Judgments Act 1838, s. 12 whereby money and banknotes could also be seized. Certain goods are exempt from execution: such tools, books, vehicles and other items of equipment as are necessary to that person for use personally by him in his employment, business or vocation and such clothing, bedding, furniture, household equipment and provisions as are necessary for satisfying the basic domestic needs of that person and his family (see now Supreme Court Act 1981, s. 138(3A)). A recent example of these exceptions is *Brookes v Harris* [1995] 1 WLR 918 where the record collection of 'Whispering' Bob Harris, a disc jockey, was held to be within the meaning of 'tools of the trade'.

50 Upon receipt by the sheriff, the writ must be indorsed with the hour, day, month and year when it was so received. Similarly, in the county court under County Courts Act 1984, s. 99(3), the bailiff must indorse the warrant of execution with the hour, day, month and year when he received it. Where there is more than one writ delivered to the sheriff priority is given to the writ first delivered (Supreme Court Act 1981, s. 133). Where there are High Court writs of *fi. fa.* and county court warrants of execution issued against the same party, priority depends upon which was delivered to the sheriff/bailiff first. This will be apparent from the respective indorsements.

51 *Pitcher v King* (1844) 5 QB 758; 114 ER 1436.

52 *Dennis v Whetham* (1874) LR 9 QB 345.

of the goods, and the proceeds being paid over to the sheriff, the execution creditor has a right of action against the sheriff for money had and received.⁵³ In practice the sheriff may decide not to remove the goods seized from the premises but may enter into what is known as a 'walking possession' agreement with the debtor. This agreement allows the goods to remain at the debtor's premises, but as the goods will be *in custodia legis*, the debtor cannot deal with them until the debt is paid.⁵⁴

(a) Effect of a Writ of *Fieri Facias*

At common law the goods of the debtor were bound from the time of the issue of the writ. This rule was taken advantage of by creditors who, following judgment, would take out a *fi.fa.* but not deliver it to the sheriff. As the goods were bound by the writ, if any further creditors came in later claiming priority over the debtor's goods, the original judgment creditor could produce the *fi.fa.* and ensure being paid first out of the proceeds of the sale of the goods. Not surprisingly, this common law rule was altered. Section 16 of the Statute of Frauds⁵⁵ in 1677 provided that 'No writ of *fi. facias* or other writ of execution shall bind the property of the goods against which such writ of execution is sued forth, but from the time that such writ shall be delivered to the sheriff . . .'.⁵⁶ The effect of this provision was that the sheriff could not seize goods which the debtor had alienated prior to the delivery of the writ but he could seize goods which had been alienated after delivery.⁵⁷

Although its purpose is clear, this form of wording has created confusion up to the present day, in that it is still not certain exactly what property interests are created or disturbed by the *fi.fa.* It could mean that the judgment creditor obtains a form of security interest in the goods.⁵⁸ This security interest may be brought into being as soon

53 *Morland v Pellatt* (1828) 8 B&C 722, 108 ER 1211; and *Bower v Hett* [1895] 2 QB 51.

54 See e.g. *National Commercial Bank of Scotland v Arcam Demolition and Construction Ltd* [1966] 2 QB 593.

55 Replaced by Sale of Goods Act 1893, s. 26 which itself was replaced by the current provision in the Supreme Court Act 1981, s. 138. In the county court, the goods are bound from the time of the application for a warrant of execution, not the time of delivery to the bailiff (see *Murgatroyd v Wright* [1907] 2 KB 333).

56 In 1856 a proviso was added to this that 'no such writ shall prejudice the title to such goods acquired by any person in good faith and for valuable consideration, unless such person had at the time when he acquired his title notice that such writ or any other writ, by virtue of which the goods of the execution debtor might be served or attached, had been delivered to and remained unexecuted in the hands of the sheriff': Mercantile Law Amendment Act 1856, s. 1. See now the Supreme Court Act 1981, s. 138.

57 With the exception of goods sold in market overt. See *Samuel v Duke* (1838) 3 M&W 622, 150 ER 1294; *Lowthal v Tonkins* (1740) 2 Eq Cas Abr 381, 22 ER 323; *Smallcomb v Cross* (1697) 1 Ld Raym 251, 91 ER 1064; *Payne v Drewe* (1804) 4 East 523, 102 ER 931.

58 The Payne Committee at para. 682 was in no doubt about this: 'The words of the section "shall bind the property in the goods" have the effect of constituting a charge upon the goods.'

as the writ is delivered to the sheriff, or possibly later upon seizure by the sheriff. The creditor may obtain no security interest, the only interest passing to the sheriff in the carrying out of his function. It is not clear from the wording what right, if any, the sheriff has in the goods. It may mean that the judgment debtor is divested of all or some of his interest in the goods. These are crucial issues in considering exactly what the interests of the execution creditor are, and how they interact with other creditors' interests.

The courts have not, at first blush, been entirely consistent in their approach to the effect of a *fi.fa.* Different approaches are discernible depending upon the era and the context in which the claim arises.

(b) Position of the Sheriff and the Judgment Creditor under the Writ of *Fieri Facias*

Delivery of the writ to the sheriff is said to bind the goods of the execution debtor from the date of delivery. It is clear that title to the goods is not altered. Any transfer by the debtor remains valid but the purchaser takes the goods subject to the rights of the execution creditor.⁵⁹

Title to the goods is not transferred to the judgment creditor by either delivery of the writ to the sheriff or by seizure of goods under it by the sheriff.⁶⁰ This point was confirmed by the House of Lords' decision in *Giles v Grover*⁶¹ in 1832. In holding that neither delivery of the writ nor seizure by the sheriff vests any title in the goods in the creditor, their lordships undertook an extremely detailed assessment of the effect of the writ of *fi.fa.*

The facts of *Giles* involved a question as to who should have priority between a creditor executing a judgment by way of *fi.fa.* and the Crown which was executing under a writ of extent.⁶² The sheriff had seized goods of the judgment debtor under the *fi.fa.* Prior to sale a writ of extent in aid⁶³ was issued against the debtor. The issue was whether the sheriff should sell the goods under the *fi.fa.* or whether the Crown had priority. The writ of extent gave priority to the Crown, due to the royal prerogative, over any subjects' unsecured claims even if the extent was issued second in time. Only if the subject had a

59 *Woodland v Fuller* (1840) 11 Ad & E 859, 113 ER 641.

60 In *Hutchinson v Johnston* (1787) 1 TR 729, 99 ER 1346 two writs of *fi.fa.* had been issued. The sheriff seized under the writ which had been delivered to him second in time. The court held that the sheriff might sell under the writ of the creditor who had delivered the writ first in time but under which he had not seized. From this it can be seen that mere seizure by the sheriff vests no rights in the seized goods in the judgment creditor. In similar circumstances in *Payne v Drewe* (1804) 4 East 532 it was held that if a sheriff seizes and sells under the second delivered writ, the creditor who had delivered the first writ has no rights to follow the goods or their proceeds but has only a remedy against the sheriff.

61 (1832) 6 Bligh NS 277, 5 ER 598.

62 A prerogative writ which was abolished by the Crown Proceedings Act 1947, s. 33.

63 A writ based upon the premise that the judgment creditor owed money to the Crown but was unable to pay it because he himself was owed money by the judgment debtor.

secured debt did the subject have priority over the Crown. *Giles* decided that seizure alone by the sheriff did not create any interest in the goods in the judgment creditor and therefore the Crown retained its priority.

Upon seizure, the sheriff acquires a 'special property' in the goods. He may sue in trespass for them and is bound to sell them. This 'special property' is explained by Patteson J as:

... merely that which results from his being the appointed officer of the law, and to enable him to sell the goods and raise the money; not that thereby the property is taken out of the debtor ... the sheriff, whilst the goods are in his hands, holds them for the benefit of any one who may have a legal charge against them, as property of the debtor.⁶⁴

Taunton J commented that:

[I]f, after seizure, the defendant pays the debt to the sheriff, he is entitled to have his goods again without any grant from the sheriff or if a leasehold, without any reassignment. So also, I apprehend, if goods in execution are burnt, or otherwise injured, without default of the sheriff, it is the loss of the defendant.⁶⁵

Title to the goods remains in the debtor until sale. Upon sale, the purchaser obtains a good title from the sheriff. At this point the debtor's title is extinguished. The sheriff is under a duty to sell and pay over the proceeds to the creditor. This is a legal duty imposed by the writ and does not constitute the sheriff as trustee for the creditor. Nowhere in *Giles* is it suggested that the execution creditor, at any point, is constituted a secured creditor.

(c) Bankruptcy Cases

Throughout the development of modern bankruptcy law the legislature introduced various provisions which impacted upon the rights of execution creditors in the subsequent bankruptcy of the judgment debtor. One such provision, introduced by section 184 of the Bankruptcy Act 1849, is to the effect (limiting the discussion to *fi.fa.* executions for present purposes) that an execution creditor cannot rely upon the 'benefit of the execution' against goods where the execution is not completed by seizure and sale prior to the bankruptcy.⁶⁶

⁶⁴ *Giles v Grover* (1832) 6 Bligh NS 277 at 292-3.

⁶⁵ *Ibid.* at 334-5. Taunton J relied upon, *inter alia*, Lord Hardwicke's dictum in *Lowthal v Tonkins* (1740) 2 Eq Ca Abr 381 at 381: 'But neither before this Statute, nor since, is the Property of the Goods altered, but continues in the Defendant till the Execution executed. The Meaning of these Words, "That the Goods shall be bound from the Delivery of the Writ to the Sheriff", is, that after the Writ is so delivered, if the Defendant makes an Assignment of his Goods, unless in Market-overt, the Sheriff may take them in Execution.'

⁶⁶ Other provisions impacting upon the execution creditor were: (1) the execution creditor received some protection from the operation of the doctrine of relation back (introduced by the Bankruptcy Act 1849, s. 133). The doctrine of relation back operated to relate the title of the trustee in bankruptcy back to the date of the first available act of bankruptcy committed within a specified period of the petition. In practice therefore it was often the case that the creditor would levy

Under the Bankruptcy Act 1869, the above rule was totally omitted. Section 12 of the 1869 Act stated that upon a debtor being adjudicated bankrupt, creditors with provable claims fell into the general bankruptcy scheme. The exception to this was that a creditor 'holding a security upon the property of the bankrupt' could continue to enforce the security. If the execution creditor could show that the process of execution had transformed the unsecured debt into a secured debt, the execution creditor could claim the benefit of the security in the debtor's bankruptcy.

In *Slater v Pinder*,⁶⁷ decided under the 1869 Act, the sheriff had seized under a *fi.fa.* the day before a bankruptcy petition was presented against the judgment debtor. He had yet to complete the sale of the goods seized when he was informed of the bankruptcy adjudication. Martin B, in the only reserved judgment of the Court of Exchequer, stated that 'the right or claim which the judgment creditor had upon the goods of his debtor is called a security'.⁶⁸

His lordship went carefully through the historical development of the bankruptcy statutory provisions relating to execution creditors and highlighted the fact that:

the words 'holding a security' are the words used in the 9th section of 21 Jac. [Bankruptcy Act 1623] and the 184th section of 12 & 13 Vict. c.106 [Bankruptcy Act 1849], to describe the interest of the plaintiff in an execution under which a sheriff has seized and is in possession of goods . . .⁶⁹

It is important to note that these provisions expressly included an execution creditor's rights under a *fi.fa.* as constituting a security interest.

Until the 1849 Bankruptcy Act, seizure by the sheriff entitled the execution creditor to payment unless an act of bankruptcy (the ground upon which a bankruptcy order was formerly founded) was

execution upon goods of which the debtor was ostensibly the owner, only to find under a subsequent bankruptcy that the trustee was in fact the person with title to the goods. Section 133 therefore gave protection to the execution creditor in this situation as long as he acted in good faith and completed the execution prior to the date of the bankruptcy petition. If the execution was completed prior to the period of relation back the creditor would be safe anyway—see *Edwards v Scarsbrook* (1862) 3 B & S 280, 122 ER 106. The Bankruptcy Act 1869, s. 95(3) introduced an amendment to this by protecting the creditor if the execution was completed by seizure and sale before the creditor received notice of an act of bankruptcy; (2) the execution itself constituted an act of bankruptcy upon which a bankruptcy order could be founded, and importantly the sheriff was directed to hold the proceeds of such sale for a specified time so that any other creditor, or the debtor himself, could intervene by bringing bankruptcy proceedings (introduced by the Bankruptcy Act 1861, s. 73). As long as the period of time had elapsed and the sheriff had paid out the execution creditor, any subsequent trustee in bankruptcy could not set the payment aside—see *ex p Villars* (1874) LR 9 Ch App 432 at 444 per Lord Cairns. The current equivalent bankruptcy provisions are contained in the Insolvency Act 1986, s. 346.

⁶⁷ (1871) LR 6 Exch 228.

⁶⁸ *Ibid.* at 236.

⁶⁹ *Ibid.* at 237.

committed prior to the seizure by the sheriff. By section 184 of the 1849 Act where an act of bankruptcy occurred prior to the execution being perfected by seizure and sale, the title of the trustee prevailed. As mentioned above, the 1869 Act repealed section 184 and the position returned to how it was before, being governed by the 'old common law of bankruptcy'⁷⁰ as Kelly CB calls it. Channell B, in applying the old rules, stated '[the creditor] had, at common law, a valid title by such seizure, of which he could only be deprived by express statutory enactment . . .'.⁷¹ The decision was affirmed by the Court of Exchequer Chamber.⁷²

It is interesting to observe the references by their lordships to the position at 'common law'. This may mean common law in its widest sense, or, as the context suggests is more likely, in a narrower sense to include only the common law of bankruptcy, a compendious expression for a number of judge-made rules engrafted onto the Bankruptcy Acts but going no further. If the narrower interpretation is the correct one, then the idea that a *fi.fa.* creditor becomes a secured creditor upon seizure by the sheriff is a concept which may only apply to cases falling to be decided under certain provisions of the Bankruptcy Acts. The statement that a 'valid title' was vested in the execution creditor appears to be at odds with *Giles* and without qualification appears to be incorrect. Channell B may have intended his words not to be construed as creating a title to the actual goods seized but merely the creation of a charge over those goods.

In *ex p Williams*⁷³ the priority dispute was between an execution creditor under a county court warrant of execution where no seizure had taken place and a trustee in liquidation by arrangement.⁷⁴ Again the matter that fell for consideration depended upon the construction of the Bankruptcy Acts.⁷⁵ It was argued that, as the Statute of Frauds stated that goods were bound by the delivery of the writ to the sheriff, the execution creditor became a secured creditor at that time. The Court of Appeal in following *Slater v Pinder* held that a 'mere right to seize property cannot properly be called a security'⁷⁶ and therefore only upon seizure of the goods did the execution creditor obtain a security over them.

In *ex p Rayner*⁷⁷ Bacon VC referred, *inter alia*, to *Slater v Pinder* and stated that the case had no bearing on the issue in *Rayner* which

⁷⁰ *Ibid.* at 239.

⁷¹ *Ibid.* at 241.

⁷² (1872) LR 7 Exch 95.

⁷³ (1872) 7 Ch App 314.

⁷⁴ Which for present purposes is 'of the same force and effect as if an order of adjudication in bankruptcy' had been made: *Re Veness* (1870) LR 10 Eq 419 at 423 per Bacon VC.

⁷⁵ The operation of the Bankruptcy Act 1869, s. 12.

⁷⁶ (1872) 7 Ch App 314 at 318 per Mellish LJ.

⁷⁷ (1872) 41 LJ Bcy 26.

involved interpretation of a different provision of the Bankruptcy Act 1869.⁷⁸

I take the law to have been established by the judgment of the House of Lords in *Giles v Grover* . . . that ‘the seizure of goods by the sheriff will not vest any property whatsoever in the creditor . . . and no property is transferred . . . to the sheriff’.⁷⁹

In the Court of Appeal James LJ, with whom Mellish LJ concurred, is reported as being in entire agreement with Bacon VC’s decision.⁸⁰ This is perhaps surprising as the date of their lordships’ decision is the same date as their decision in *ex p Williams*. It may be that the only way to reconcile these potentially divergent decisions is to recognize the effect of seizure under section 12 and its successors as having a different effect than at common law or under other provisions of the Bankruptcy Acts. A more convincing reconciliation would be to restrict the decision in *Rayner* to holding that no title to the seized goods passed to the sheriff nor to the execution creditor. This does not preclude the creditor having the benefit of a charge over the seized assets.

The case of *Re Clarke*⁸¹ differs from the above as it does not involve construction of the bankruptcy statutes. The facts of the case were that a debtor who had his goods seized under a writ of *fi. fa.* subsequently had a receiver appointed over his affairs under the Lunacy Act 1890 on the ground that he was of unsound mind. The receiver claimed that under the Lunacy Act the lunatic debtor’s assets were entitled to be protected from execution. The Court of Appeal found that there was no power available to the court to protect the assets of the lunatic in the absence of the receiver having actually taken possession of the lunatic’s assets prior to the execution. Importantly, Lindley MR stated:

It is very true that the property in goods seized under a *fi. fa.* remains in the execution debtor until sale: *Giles v Grover*. But it is no less true that after seizure and before sale the execution creditor is as regards those goods in the position of a secured creditor: see *Ex parte Williams* and *Slater v Pinder*. He had a legal right as against the execution debtor—i.e. owner of the goods—to have the goods sold and to be paid out of the proceeds of sale.⁸²

Lindley MR is clearly of the view that although no property in the goods has passed to the execution creditor on seizure, the creditor at that point becomes a secured creditor.

78 Section 87.

79 (1872) 41 LJ Bcy 26 at 30.

80 *Ex p Rayner* (1872) 7 Ch App 325.

81 [1898] 1 Ch 336.

82 *Ibid.* at 339.

Section 184 of the Bankruptcy Act 1849 was effectively reintroduced by section 45 of the Bankruptcy Act 1883.⁸³ Both provisions prevented the creditor from retaining the 'benefit of the execution' unless the execution was completed by seizure and sale prior to the presentation of the bankruptcy petition. Case law under these provisions frequently turned upon what should happen if the sheriff had seized but not sold prior to the petition, although some payment had been received from the debtor. Did 'benefit of the execution' include any money received by the creditor under the execution, or could he keep what he had received?

After some judicial inconsistency, the Court of Appeal in *Re Andrew*⁸⁴ decided that the phrase referred to the charge created in favour of the execution creditor by delivery of the writ to the sheriff, in so far as the charge still subsisted at the time of the bankruptcy. It did not refer to any moneys received by the creditor prior to the bankruptcy by virtue of the execution. In considering the meaning of the phrase 'benefit of the execution' in *Re Godwin*⁸⁵ Luxmoore J stated:

First, what is the position at common law, and apart from the statutory provisions in Bankruptcy Acts, when an execution creditor issues a writ of *fi. fa.* and delivers it to the sheriff? From the moment of its delivery, the goods are bound for the benefit of the execution creditor . . . the execution creditor has the first right to the resulting charge on the goods. This charge puts the execution creditor in a better position than the other creditors of the judgment debtor. When the sheriff has seized the goods, no one else can deal with them so long as the execution remains in force. This result can properly be described as the benefit of the execution from the execution creditor's point of view.

His lordship later states that the phrase 'on the true construction of the section, refers solely to the protection obtained by an execution creditor by reason of the issue of the writ of *fi. fa.* and its delivery to the sheriff'.⁸⁶ Although slightly ambiguous in that this *dictum* may be interpreted as suggesting the charge comes into effect on delivery of the writ to the sheriff, the better view is that the court was merely repeating the words of the statutory successor to the Statute of Frauds⁸⁷ and is relatively clear that the charge only arises upon seizure by the sheriff.

Re Godwin was followed in *Re Samuels*⁸⁸ and in *Re Andrew*.⁸⁹ In the latter case Lord Wright MR said that the 'benefit of the execution'

83 This provision became the Bankruptcy Act 1914, s. 40. The modern equivalent is the Insolvency Act 1986, s. 346.

84 [1937] Ch 122 overruling *Re Ford* [1900] 1 QB 264; *Re Godding* [1914] 2 KB 70; *Re Fairley* [1922] 2 Ch 791; *Re Brelsford* [1932] 1 Ch 24; and *Re Kern* [1932] 1 Ch 555 and following *Re Godwin* [1935] Ch 213 and *Re Samuels* [1935] Ch 341.

85 [1935] Ch 213 at 219–20.

86 *Ibid.* at 223.

87 Sale of Goods Act 1893, s. 26 which itself was replaced by the current provision in the Supreme Court Act 1981, s. 138.

88 [1935] Ch 341.

89 [1938] Ch 122.

cannot refer to money already paid under the execution nor can it operate on goods already sold with the proceeds applied to partial discharge of the debt but it 'can only refer, in our opinion, to the charge still remaining under the still subsisting execution for the balance of the debt'.⁹⁰

(d) Is an Execution Creditor under a writ of *Fi.Fa.* a Secured Creditor?

It is not immediately easy to reconcile all the above case law. It seems that at times the courts have taken the view that the execution creditor obtains no interest in the goods seized and cannot therefore be seen to be a secured creditor upon seizure by the sheriff. Other cases suggest seizure does constitute the creditor a secured creditor. It is not clear whether such decisions are limited to interpretation of the Bankruptcy Acts or are statements of general law. Others seem to go even further and suggest delivery of the writ to the sheriff constitutes the creditor a secured creditor, although such a suggestion was discounted by Lord Hardwicke in 1740⁹¹ and remains untenable.

It is important to bear in mind that at the time *Giles* was decided, the equitable charge had yet to be invented. The principal non-possessory type of security over personalty recognized at this time was the mortgage—whether legal or equitable.⁹² This type of mortgage does not require the mortgagee to be in possession of the mortgaged assets but does transfer title in the goods to the mortgagee. It is no surprise that the House of Lords refused to recognize that any property passes to the execution creditor (or the sheriff) under a *fi.fa.* as clearly no title in the seized assets does pass. Seventeen years after *Giles*, the Bankruptcy Act 1849, in defining the meaning of security, referred to mortgages and liens but not charges.⁹³

The exact moment when the equitable charge was invented and recognized as such is not entirely clear. It was used as early as 1859⁹⁴ in an attempt to circumvent the Bills of Sale Act 1854 and was later expressly recognized by the courts in 1867 in *Brown v Bateman*.⁹⁵ It was included in the definition of 'security' in section 16 of the Bankruptcy Act 1869. It is noteworthy that cases such as *Slater, Williams* and *Clarke* were decided after the 1869 Act definition was introduced. It is the essence of an equitable charge that the chargee does not have possession or title to the charged assets but does have a right to have

90 *Ibid.* at 136. *Re Love* [1951] Ch 952 followed *Re Andrew* and *Re Godwin*.

According to Danckwerts J at 959, the benefit of the execution refers 'to the charge which a judgment creditor obtains by the issue of the execution'.

91 *Lowthal v Tonkins* (1740) 2 Eq Ca Abr 381.

92 See R. Gregory and P. Walton, 'Fixed and Floating Charges—a Revelation' [2001] LMCLQ 123.

93 Section 184.

94 *King v Marshall* (1864) 33 Beav 565, 55 ER 488.

95 (1867) LR 2 CP 272.

the assets sold to pay off the charged debt.⁹⁶ This right is defeasible upon payment of money. In the case of a *fi.fa.* creditor, the creditor has the right to force the sheriff to seize and sell the judgment debtor's goods in order to pay the judgment debt. This right is defeasible, in that the judgment debtor can pay off the debt and the creditor's rights under the execution cease at that moment.

It is therefore submitted that an execution creditor under a writ of *fi.fa.* does, as Lindley MR asserts in *Clarke*, become at common law a secured creditor once the sheriff has seized the debtor's goods. The nature of the security appears to be that of a fixed equitable charge.

III. Execution Creditors and Formal Insolvency Procedures

The foregoing discussion deals with whether or not an execution creditor becomes a secured creditor at any stage of the execution. If the judgment debtor is solvent it is likely that execution creditors will get paid out and so will not be overly concerned as to their secured status or otherwise. Where the issue becomes of greater importance is when the debtor enters a formal insolvency procedure. If the execution creditor can claim a secured interest one would expect the creditor to be paid out in priority in any subsequent insolvency of the debtor. As will be seen, this is not quite the case. In some non-terminal procedures (voluntary arrangements and administration) the secured status is potentially crucial. In another non-terminal procedure (receivership) the courts have partly ignored the execution creditors' claim to be secured creditors. In terminal procedures (liquidation and bankruptcy) the Insolvency Act 1986, in the main, overrides any security interest obtained by the execution creditor unless completed prior to the liquidation or bankruptcy.

i. Execution Creditors versus Floating Charge Holders (Companies in Receivership)

A common priority dispute exists between an execution creditor on the one hand and the holder of a floating charge on the other. The dispute will frequently arise when the execution creditor has instituted enforcement procedures and the company is put into receivership before the creditor is paid out.⁹⁷ Logic would dictate that if the execution creditor has the benefit of a security interest before the floating charge crystallizes then the execution creditor should win.

⁹⁶ See *Morris v Agrichemicals Ltd* [1997] BCC 965 at 972 per Lord Hoffman and *Re Cosslett Contractors Ltd* [1997] BCC 724 at 733 per Millett LJ.

⁹⁷ It should be noted that s. 250 of the Enterprise Act 2002 has effectively abolished a floating charge holder's power to appoint an administrative receiver where the floating charge is executed after the commencement of the Enterprise Act. Administrative receivership will remain a significant insolvency procedure for many years to come in relation to pre-existing floating charges.

Unfortunately, in this area, logic has been conspicuous by its absence.

The case law which exists is most remarkable by an almost complete absence of consideration of the rights given to execution creditors upon enforcement. The analysis, such as it is, concentrates on what rights are given to the holder of a floating charge.⁹⁸ The most unfortunate thing about this is that the cases fall broadly into two diametrically opposed groups as to what a floating charge actually is. It is small wonder then that the case law fails to be entirely logical or consistent either on its own terms or with the wider case law determining the rights of execution creditors.

(a) 'Licence' Theory

The two categories of case law differ fundamentally as to what rights in the charged property a floating charge gives to the chargee prior to crystallization. The nature of what exactly a floating charge is remains to some extent uncertain even today.⁹⁹ In its early days the courts wrestled primarily with two possibilities. The first group of cases proceeded on the basis that a floating charge created an immediate interest in the charged property. This is what Professor Pennington later labelled the 'licence' theory.¹⁰⁰ Essentially the floating charge gave the chargee an immediate security interest in the assets but gave the chargor company a licence to continue to use the assets in the ordinary course of business.

The starting point for the present discussion is the Court of Appeal decision in *Re Standard Manufacturing Company*¹⁰¹ where Fry LJ observed that a floating charge 'does create a charge, but gives a licence to the company to carry on its business'.¹⁰² It has always been the case that execution creditors can only take the judgment debtor's assets 'subject to equities'.¹⁰³ According to the first line of case law, these 'equities' included a floating charge. These cases¹⁰⁴ decide that the

⁹⁸ The exceptions to this are the cases of *Norton v Yates* [1906] 1 KB 112 and *Cairney v Back* [1906] 2 KB 746 in both of which there was some discussion of the effect of garnishee orders.

⁹⁹ Although some certainty as to what a floating charge actually is has been introduced by the Privy Council in *Agnew v Commissioner of Inland Revenue (Re Brumark Investments Ltd)* [2001] 2 AC 710, the decision is not entirely helpful; see e.g. R. Gregory and P. Walton, 'Brumark and the Privy Council—Was the Curia In?' (2002) 5 *Receivers, Administrators and Liquidators Quarterly* 25.

¹⁰⁰ R. Pennington, *Company Law*, 8th edn (Butterworths: London, 2001) at 539–41.

¹⁰¹ [1891] 1 Ch 627.

¹⁰² *Ibid.* at 641 citing Jessel MR in *Re Florence Land and Public Works Co* (1878) 10 Ch D 530 at 541.

¹⁰³ *Re Standard Manufacturing Co* [1891] 1 Ch 627 at 641.

¹⁰⁴ *Re Standard Manufacturing Co* [1891] 1 Ch 627; *Re Opera* [1891] 3 Ch 260; *Davey v Williamson* [1898] 2 QB 194; *Simultaneous Colour Printing Syndicate v Foweraker* [1901] 1 QB 771; *Duck v Tower Galvanising Co* [1901] 2 KB 314; *Norton v Yates* [1906] 1 KB 112; *Cairney v Back* [1906] 2 KB 746. *Norton* and *Cairney* even go as far as to suggest that even after a garnishee order is made absolute, a subsequently created floating charge will still take priority.

floating charge takes priority over an execution creditor even if the charge has yet to crystallize, as long as the debenture is issued prior to the date of the execution.¹⁰⁵

After referring to some of the cases in this category Buckley J said in *Re London Pressed Hinge*:¹⁰⁶

[T]he fact is that the appointment of a receiver does not, as between the execution creditor and the debenture holder, disappoint the execution creditor of anything which would otherwise be his right . . . [I]t results that the creditor never had any right as between himself and the debenture holder to enforce payment in priority to the debenture holder. If he availed himself of his legal right to judgment and execution the debenture holder could intercept his execution.¹⁰⁷

In *Re Opera*,¹⁰⁸ Lindley LJ, bound by the Court of Appeal's decision in *Re Standard Manufacturing*, commented:

[A]fter the decision in *In Re Standard Manufacturing Company* it seems tolerably plain and settled that the rights of the holders of debentures must prevail even as against the execution creditor, at least before sale. What the position of the debenture holders is after the property is sold and the money handed over, I do not know, and I will not say at this moment.¹⁰⁹

There is a logic to his lordship's statement. If the licence theory is correct, the floating charge holder must have priority over the execution creditor. It does not matter whether the *fi.fa.* execution creditor obtains a charge by way of execution as the debenture holder has the charge which was created first and so must have priority. It must be remembered that Lindley's judgment in *Clarke* is clear that the effect of seizure under a *fi.fa.* is to give the execution creditor a security interest. His lordship's only query in *Opera* is in regard to what the position would be if the execution was complete to the point that the money had been handed over to the execution creditor. Would the debenture holder be able to assert his rights over the proceeds of sale? The query is reasonable in the context. Floating charges were not at the time publicly registrable,¹¹⁰ therefore the sheriff and the execution creditor could not have any constructive notice of the existence of the charge. The execution creditor has a legal right to force the sheriff to seize, sell and hand over the proceeds. Once this process is complete, could a debenture holder, with merely equitable rights of

105 See e.g. *Simultaneous Colour Printing Syndicate v Foweraker* [1901] 1 QB 771 at 773 per Wright J.

106 [1905] 1 Ch 576.

107 *Ibid.* at 582. Buckley J's disquiet at the consequences of his judgment was one of the matters relied upon in a minority report of the Loreburn Committee (*Report of the Company Law Amendment Committee*, Cd 3052 (1906)) which recommended the abolition of the floating charge.

108 [1891] 3 Ch 260.

109 *Ibid.* at 267.

110 Floating charges were first made registrable by the Companies Act 1900, s. 14.

which the execution creditor had no notice, still claim priority? As Lord Lindley implies, there is no easy answer to this question.

(b) 'Mortgage of Future Assets' Theory

The second line of cases looking at floating charge holders' priority battles with execution creditors views the floating charge as attaching to nothing until something happens to crystallize the charge.¹¹¹ This is what Professor Pennington calls the 'mortgage of future assets' theory.¹¹² In *Robson v Smith*,¹¹³ Romer J clearly states that a floating charge attaches to nothing until crystallization. His lordship interprets Fry LJ's *dictum* in *Standard Manufacturing* to the effect that a floating charge creates a charge but gives the company a licence to carry on business with the charged assets, as meaning the company can deal with property in the ordinary course of business and such dealing 'will be binding on the debenture holders, provided that the dealing be completed before the debentures cease to be merely a floating security'.¹¹⁴ Romer J was able to distinguish *Standard Manufacturing* and *Opera* on the facts as in both those cases liquidation intervened to crystallize the charge before the sheriff sold the goods seized. On the facts of *Robson* a garnishee order had been made absolute prior to crystallization and so took priority over the floating charge. The result of applying the mortgage of future assets theory to the priority dispute between an execution creditor and a floating charge holder is therefore that the execution creditor wins if the execution is complete prior to crystallization of the floating charge. Although ostensibly consistent with *Standard Manufacturing* and *Opera* on the facts, the view in *Robson* of the effect of a floating charge is clearly different.¹¹⁵

*Evans v Rival Granite Quarries Ltd*¹¹⁶ is widely regarded as settling the law as to disputes between floating charges and execution creditors. It does this, following Romer J's lead in *Robson*, by a not very convincing reconciliation of only some of the previous cases. In *Evans* a judgment creditor had obtained a garnishee order *nisi* and the court had subsequently made the order absolute. By this time a floating charge holder had still not intervened sufficiently to crystallize the charge (he had merely given notice to the garnishee bank, the company's bankers, claiming to be paid the company's bank balance which was subject to the garnishee order).

111 See e.g. *Robson v Smith* [1895] 2 Ch 118 at 124; *Taunton v Sheriff of Warwickshire* [1895] 1 Ch 734; and *Evans v Rival Granite* [1910] 2 KB 979.

112 R. Pennington, *Company Law*, 8th edn (Butterworths: London, 2001) at 539–41.

113 [1895] 2 Ch 118.

114 *Ibid.* at 124.

115 See also *Robinson v Burnell's Vienna Bakery Co* [1904] 2 KB 624 where it was decided on the facts that payment to the sheriff who had seized under a *fi.fa.* was equivalent to payment to the execution creditor.

116 [1910] 2 KB 979.

Two of the Court of Appeal judges dealt with the conflicting case law in a rather dismissive manner.¹¹⁷ The first of these, Vaughan-Williams LJ, having considered *Robson*, stated that 'it is impossible . . . to say that an execution may not be enforced so long as the debenture holders have not got a receiver appointed or have not done something in regard to the licence to the company to continue carrying on its business'.¹¹⁸ His lordship then considered a number of early decisions on the nature of a floating charge¹¹⁹ and clearly adheres to the mortgage of future assets principle that a floating charge holder has no interest in specific charged assets until crystallization. His lordship sidesteps the contradictions of reasoning in *Standard Manufacturing and Opera* by stating 'that in each of those cases the circumstances were such that the execution could have been defeated by the debenture holder by reason of the fact that before any sale had been effected circumstances had happened which entitled him to determine the right of the company to carry on business'.¹²⁰

The second judge, Fletcher-Moulton LJ, also relies on a number of early decisions on the nature of a floating charge¹²¹ and concludes that in order to have priority over an execution creditor a floating charge holder must intervene to crystallize the charge, not merely show a default has occurred.¹²² Importantly his lordship states that a floating charge allows the company to carry on its business in the ordinary way which includes 'a liability to the processes of the law if it does not pay its debts'.¹²³ Fletcher-Moulton LJ considers *Standard Manufacturing and Opera* as cases where prior to sale by the sheriff, the floating charges had actually crystallized (a point not mentioned in the cases themselves):

When in these cases the goods were seized in execution, the goods were not by such seizure finally alienated from the company (for the company might have paid out the execution), so that time was left for the rights of the debenture holders to develop into a fixed charge on the goods.¹²⁴

117 See e.g. Vaughan-Williams LJ, *ibid.* at 988 stating that a detailed examination of the cases would 'serve no useful purpose'.

118 *Ibid.* at 988.

119 *Wheatley v Silkstone and Haigh Moor Coal Co* (1885) 29 ChD 715; *Re Panama, New Zealand and Australian Royal Mail Co* (1870) 5 Ch App 318; *Government Stock and Other Securities Investment Co Ltd v Manila Ry Co Ltd* [1897] AC 81.

120 [1910] 2 KB 979 at 991.

121 *Wheatley v Silkstone and Haigh Moor Coal Co* (1885) 29 ChD 715; *Re Panama, New Zealand and Australian Royal Mail Co* (1870) 5 Ch App 318; *Re Colonial Trusts Corp'n* (1879) 15 ChD 465; *Illingworth v Houldsworth* [1904] AC 355. His lordship did also briefly consider *Davey*, the correctness of which he doubted, and he also considered *Cairney* to be incorrectly decided.

122 [1910] 2 KB 979 at 993.

123 *Ibid.* at 995. This supports the view of Romer J in *Robson* and overrules the statements made by Lord Russell in *Davey v Williamson* [1898] 2 QB 194 at 200 and Warrington J in *Norton v Yates* [1906] 1 KB 112 at 124 to the effect that to suffer an execution is not business being carried on in the ordinary way.

124 [1910] 2 KB 979 at 996.

Buckley LJ attempted a more comprehensive consideration of the cases dealing with priority issues between execution creditors and floating charge holders. In attempting to reconcile a number of cases, his lordship decided that the decisive factor was whether or not the execution creditor had actually received the money owed prior to crystallization. In arriving at this result, Buckley LJ found that even obtaining a garnishee order absolute prior to crystallization¹²⁵ did not give the execution priority.¹²⁶ The consequence of this judgment is that the execution must be absolutely complete prior to crystallization in order to win out against a floating charge. Buckley LJ did not consider whether or not seizure by the sheriff under a *fi.fa.* or a garnishee order *nisi* being granted gave the execution creditor a charge in priority to the floating charge. For these purposes execution appears to be complete only when the execution creditor has the money in his hands or possibly when the sheriff has the proceeds of a sale under a *fi.fa.* in his hands.

(c) The Result

The law is not entirely satisfactory. *Evans* attempts to reconcile the previous inconsistent case law and the resultant decision therefore lacks coherence. Although *Evans* recognizes that the floating charge gives no fixed interest in the charged goods until crystallization, it does not recognize that an execution creditor may have the benefit of a fixed charge by, for example, seizure by the sheriff under a *fi.fa.* The sheriff must have seized and sold the goods, if not actually handed over the money to the execution creditor prior to crystallization, in order for the creditor to have priority over the floating charge.¹²⁷ The common law rules for determining when an execution creditor becomes a secured creditor are therefore ousted in disputes with floating charge holders.

ii. Liquidation

There are a number of overlapping provisions restricting the rights of execution creditors which apply where the debtor company is being wound up. There is no great logic to the provisions; some apply specifically to compulsory winding up only but may be applied in voluntary liquidation at the discretion of the court. Some apply after the commencement of the winding up whilst others only apply once the winding up has occurred. Some provisions have been interpreted by the courts in an unlikely manner. The consequence of the provisions is

¹²⁵ *Cairney v Back* [1906] 2 KB 746.

¹²⁶ His lordship also found *Davey v Williamson* [1898] 2 QB 194 to be correctly decided, seemingly identifying an early form of automatic crystallization not mentioned in the case itself.

¹²⁷ Although floating charge holders may still claim priority if they have an appropriately worded automatic crystallization clause, that is a separate matter.

effectively that execution creditors who have yet to be paid out under the execution will lose out in the winding up of the judgment debtor.

The policy behind the rules applying to execution creditors' rights in winding up was summarized by James LJ in 1874:

Parliament has enacted that in the case of a winding up the assets of the company so wound up are to be collected and applied in discharge of its liabilities. That makes the property clearly trust property. It is property affected by the Act of Parliament with an obligation to be dealt with by the proper officer in a particular way. Then it has ceased to be beneficially the property of the company; and, being so, it has ceased to be liable to be seized by the execution creditors of the company.¹²⁸

Under section 126 of the Insolvency Act 1986, upon the presentation of a petition for a compulsory winding up, the company, a creditor or a contributory may ask the court to stay execution (or other civil proceeding) against the company. If no stay is obtained, the execution (or other proceeding) may be continued with until such time as a winding up order is made (or provisional liquidator appointed). In the absence of special circumstances the court will restrain execution in order to ensure an equal distribution of assets amongst the company's creditors.¹²⁹

Under section 130 of the Insolvency Act 1986, once a winding up order is made, no action or proceeding shall be proceeded with or commenced against a company without leave of the court.¹³⁰ Action or proceeding in this context includes execution.¹³¹ It is highly unlikely that the court will grant leave to a creditor to enforce a judgment against a company in compulsory liquidation as it would secure an advantage to which the creditor would not be properly entitled if the assets were to be administered in accordance with the winding up provisions.¹³²

Although there are no similar specific provisions governing voluntary liquidations, the liquidator may apply to the court under either section 126 or section 130 to have the execution stayed or set aside, by virtue of the court's powers under section 112.¹³³ The onus to show why the execution should be stayed is on the liquidator.¹³⁴ The court's power to stay proceedings includes any situation where the proposed action threatens an equal distribution of the company's assets, and so

128 *Re Oriental Inland Steam Co* (1874) 9 Ch App 557 at 559. The same principle was applied to voluntary winding up in *IRC v Olive Mill Ltd* [1963] 1 WLR 712.

129 *Bowkett v Fullers United Electric Motors Ltd* [1923] 1 KB 161.

130 For the rationale of s. 130 see *Re David Lloyd & Co* (1877) 6 ChD 339 at 344 per James LJ.

131 *Re Artistic Colour Printing Co* (1880) 14 ChD 502 at 505; *Anglo-Baltic and Mediterranean Bank v Barber & Co* [1924] 2 KB 410.

132 A. Keay, *McPherson's Law of Company Liquidations* (Sweet and Maxwell: London, 2001) 330–6.

133 See *Anglo-Baltic and Mediterranean Bank v Barber & Co* [1924] 2 KB 410.

134 See *Currie v Consolidated Kent Collieries Corp*n [1906] 1 KB 134.

is likely to be granted to prevent an execution creditor enforcing judgment.¹³⁵

Under section 128 of the Insolvency Act 1986 any execution put in force after the commencement of a compulsory winding up is void.¹³⁶ The meaning of 'put in force' in the case of a *fi.fa.* is when the goods are seized¹³⁷ and so when a charge has been created over the assets.¹³⁸ If this does not occur until after commencement of the winding up the execution is void. Despite the very definite language of section 128, it has long been held that the court may give leave to a creditor to continue with the execution, where the process had begun, for example, the writ of *fi.fa.* had been issued, even though not 'put in force'.¹³⁹ In the absence of special circumstances rendering it inequitable not to allow the creditor to continue with the execution, leave will be refused. If the creditor has been prevented from enforcing due to some fraud or trickery,¹⁴⁰ the court may grant leave to complete the execution. It is necessary to show something greater than the 'usual delaying' tactics or excuses being employed by the non-paying company.¹⁴¹

Under section 183 of the Insolvency Act 1986 if the execution has begun prior to the winding up, the creditor can only retain the 'benefit of the execution'¹⁴² or attachment if the process has been completed prior to the commencement of winding up.¹⁴³ An execution against goods is 'completed' in this context by seizure and sale under a *fi.fa.* or by the making of a charging order.¹⁴⁴ Attachment of a debt is completed by receipt of the debt.¹⁴⁵ A voluntary liquidation commences upon the members' resolution to wind up¹⁴⁶ and a compulsory liquidation commences (in most cases) with the presentation of the petition to the court.¹⁴⁷ If the creditor had notice of the calling of a meeting of members to consider a resolution to wind up, the date upon which the

135 *Re Dicksmith (Manufacturing) Ltd* [1999] 2 BCLC 686.

136 Insolvency Act 1986, s. 128.

137 *Re London & Devon Biscuit Co* (1871) LR 12 Eq 190.

138 *Croshaw v Lyndhurst Ship Co* [1897] 2 Ch 154.

139 This discretion appears to originate in *Re The Great Ship Co* (1863) 4 De GJ & S 63, 46 ER 839 and was swiftly confirmed in *Re Exhall Coal Mining Co* (1864) 4 De GJ & S 377, 46 ER 964. Despite the logic of its origins being subsequently questioned (see e.g. *Re Lancashire Cotton Spinning Co* (1887) 35 ChD 656) the principle is now well established.

140 *Re London Cotton Co* (1866) LR 2 Eq 53.

141 *Re Redman (Builders) Ltd* [1964] 1 All ER 851; *Re Caribbean Products (Yam Importers) Ltd* [1966] Ch 331.

142 The meaning of 'benefit of the execution' under the reasoning in *Re Andrew* refers to the charge obtained by the execution creditor, not any money actually received by the creditor under the execution.

143 Insolvency Act 1986, s. 183(1).

144 *Ibid.* s. 183(3)(a).

145 *Ibid.* s. 183(3)(b). It remains to be seen whether the new third party debt orders will be viewed as proceedings which attach a debt.

146 *Ibid.* s. 86.

147 *Ibid.* s. 129.

creditor received notice is substituted for the date of the commencement of winding up.¹⁴⁸ The court has a wide discretion to set aside the liquidator's right to deny the execution creditor.¹⁴⁹ This discretion gives the court 'a free hand to do what is right and fair according to the circumstances of each case'.¹⁵⁰ In practice, in the absence of fraud or trickery,¹⁵¹ weighty reasons must exist before the court will exercise its discretion to depart from the *pari passu* principle by permitting a creditor to retain the benefit of an incomplete execution.¹⁵²

If goods have been seized by the sheriff but not yet sold, and if the sheriff is given notice of a winding up order or resolution to wind up voluntarily, the sheriff must, on request, deliver the assets seized to the liquidator. The costs of the execution are a first charge on these assets.¹⁵³

If the execution is for a sum greater than £500,¹⁵⁴ after sale, the sheriff must retain the sum of money for 14 days.¹⁵⁵ If the sheriff receives notice during this period of a petition for compulsory winding up or that a meeting of members has been called to consider a voluntary winding up resolution, if a winding up results, the sheriff must pay the money over to the liquidator who has priority over the execution creditor.¹⁵⁶ The court again has a discretion to set aside the liquidator's rights in favour of the creditor to such extent and subject to such terms as it thinks fit.¹⁵⁷

In summary, the execution creditor who has not yet been paid out will almost always be relegated to the ranks of the unsecured creditors in the winding up of the judgment debtor.

iii. Bankruptcy

The ideal of equal division of the insolvent's assets free from execution creditor harassment also underpins the rules in bankruptcy.¹⁵⁸ Somewhat frustratingly, the provisions, although largely mirroring those in compulsory liquidation, are drafted slightly differently. It is important to note that the commencement of the bankruptcy is the date of the bankruptcy order, not the date of the presentation of the petition.¹⁵⁹ There seems no logical reason for this difference.

The court may stay any executions at any time when proceedings on a bankruptcy petition are pending or when the debtor has been

148 *Ibid.* s. 183(2)(a).

149 *Ibid.* s. 183(2)(c).

150 *Re Grosvenor Metal Co* [1950] Ch 63 at 65 per Vaisey J.

151 See *Re Suidair International Airways Ltd* [1951] Ch 165.

152 *Re Caribbean Products (Yam Importers) Ltd* [1966] Ch 331.

153 Insolvency Act 1986, s. 184(1) and (2).

154 Insolvency Proceedings (Monetary Limits) Order 1986 (SI 1986/1996).

155 Insolvency Act 1986, s. 184(3).

156 *Ibid.* s. 184(4).

157 *Ibid.* s. 184(5).

158 *Ibid.* ss. 285 and 346.

159 *Ibid.* s. 278. In a compulsory liquidation the date of commencement is the date of the petition (s. 129).

adjudged bankrupt.¹⁶⁰ After the making of the bankruptcy order no creditor with a provable debt can obtain any remedy against the property of the bankrupt.¹⁶¹ In the event of the bankruptcy of the judgment debtor the execution creditor can retain the 'benefit of the execution'¹⁶² or attachment or sums paid to avoid it¹⁶³ only if it is completed prior to the commencement of the bankruptcy.¹⁶⁴ Execution is complete for these purposes against goods by seizure and sale, under section 1 of the Charging Orders Act 1979 when the charging order¹⁶⁵ is made or under an attachment of a debt by receipt of the debt.¹⁶⁶

If the execution has been commenced by *fi.fa.* and seizure has occurred but no sale has yet been made, if notice is given to the sheriff of the judgment debtor's bankruptcy, the sheriff must, on request, hand over the goods to the estate. In such circumstances, the costs of the execution will constitute a first charge on the goods or money.¹⁶⁷

Where the value of the judgment being enforced exceeds £500,¹⁶⁸ even where the goods have been sold and therefore the execution deemed complete, the sheriff must not hand over the proceeds to the execution creditor within 14 days from the date of sale or while a bankruptcy petition is pending.¹⁶⁹ If the sheriff is given notice of a petition for bankruptcy against the debtor during this 14-day period he must await the fate of the petition. If a bankruptcy order is made the money held by the sheriff falls into the bankrupt's estate and the sheriff must pay the proceeds, after deducting the costs of the execution, to the official receiver or trustee in bankruptcy (if there is one).¹⁷⁰

160 *Ibid.* s. 285(1). The equivalent provision for companies in compulsory winding up is s. 126.

161 *Ibid.* s. 285(3). The provision dealing with the same issue in compulsory winding up is s. 130. For execution against property acquired by the bankrupt after the bankruptcy order see s. 346(8).

162 The meaning of 'benefit of the execution' under the reasoning in *Re Andrew* refers to the charge obtained by the execution creditor, not any money actually received by the creditor under the execution.

163 Putting onto a statutory footing cases such as *Re Godwin* [1935] Ch 213 and *Marley Tile Co Ltd v Burrows* [1978] QB 241.

164 Insolvency Act 1986, s. 346(1). The provisions in winding up equivalent to s. 346 are ss. 183–4.

165 See *Roberts Petroleum Ltd v Bernard Kenny Ltd* [1983] 2 AC 192 where under the equivalent provision for companies (then Companies Act 1948, s. 323) the House of Lords ruled that in principle where a charging order *nisi* was made prior to the commencement of a winding up, the court should not make the order absolute to the prejudice of the general creditors.

166 It remains to be seen whether the new third party debt orders will be viewed as proceedings which attach a debt.

167 Insolvency Act 1986, s. 346(2).

168 Insolvency Proceedings (Monetary Limits) Order 1986 (SI 1986/1996).

169 Insolvency Act 1986, s. 346(4).

170 *Ibid.* s. 346(3) and (4).

The court does have a discretion to set aside the rights of the estate in favour of the execution creditor although such applications are unlikely to be met with success.¹⁷¹

iv. Voluntary Arrangements

Voluntary arrangements may be entered into by either an individual or a corporate debtor. The purpose of voluntary arrangements is to allow the debtor an opportunity to put forward to the debtor's creditors a proposal aimed at reaching a settlement of the debtor's affairs. It may promise a set percentage only of the overall debt owed or full payment over a longer period of time. Importantly, before a voluntary arrangement becomes binding upon the creditors the proposal must be approved by a majority of greater than 75 per cent in value of unsecured creditors. The voluntary arrangement cannot affect the rights of secured creditors to enforce their security unless they agree to be bound.¹⁷²

An individual wishing to propose a voluntary arrangement has the ability to ask the court for an interim order¹⁷³ which creates a moratorium on proceedings against the insolvent debtor. The order is designed to give a brief breathing space whereby the proposal can be drafted free from creditor harassment. No execution may be commenced or continued with during the period of the interim order.¹⁷⁴ No such protection is available for companies¹⁷⁵ although for small companies¹⁷⁶ the provisions of the Insolvency Act 2000¹⁷⁷ provide a similar, although more extensive moratorium.

Once the voluntary arrangement is approved, it is given effect to under its own terms and will expressly prevent creditors bound under it from enforcing their rights against the debtor whilst the voluntary arrangement remains in force.¹⁷⁸

In the context of an individual voluntary arrangement, *Peck v Craighead*¹⁷⁹ considered the status of an execution creditor under a *fi.fa.* after seizure of the debtor's assets but prior to sale. In this case the debtor proposed an individual voluntary arrangement but prior to

171 *Ibid.* s. 346(6). Russell LJ in the Court of Appeal in *Re Caribbean Products (Yam Importers) Ltd* [1966] Ch 331 at 351 found it hard to foresee any circumstances where the court's discretion could be properly exercised.

172 Insolvency Act 1986, s. 4(3) for company voluntary arrangements and s. 258(4) for individual voluntary arrangements. See *Calor Gas Ltd v Piercy* [1994] BCC 69.

173 See Insolvency Act 1986, ss. 252–5.

174 *Ibid.* s. 252(2). Prior to the order being made, but any time after the application to the court is made, the court may stay any execution pending the hearing (s. 254).

175 When the Insolvency Act 1986 was passed it seems to have been assumed that a company, wishing protection during the period when it considered the terms of a voluntary arrangement proposal, would use the moratorium available to it by petitioning for an administration order.

176 Defined by reference to the Companies Act 1985, s. 247(3).

177 See ss. 1 and 2 and Sch. 1 para. 12.

178 See e.g. the precedent individual voluntary arrangement provided by the Association of Business Recovery Professionals (R3) at paras. 4(3), 5(1) and 6(1).

179 [1995] 1 BCLC 337.

the creditors' meeting held to consider his proposal, a judgment creditor proceeded to issue a writ of *fi. fa.* under which the sheriff seized goods. The issue was whether or not the creditor became a secured creditor for the purposes of voting on the voluntary arrangement. Section 383(2) of the Insolvency Act 1986 defines a security as 'a mortgage, charge, lien or other security'. The court, in following *Slater v Pinder* and *ex p Williams*, held that the judgment creditor became a secured creditor upon seizure:

I infer that the security right which an execution creditor has under a *fi. fa.*, which has been acted upon by seizure, is not unlike a lien, which is a security right expressly contemplated by s.383(2). The fact that such a security right has not been enforced is nothing to the point. It is enough that the debtor's property in the goods is bound. It is clearly irrelevant that the property has not yet passed out of the debtor's hands as on completion of the execution by sale.¹⁸⁰

The importance of this decision is that an execution creditor who has become secured before the voluntary arrangement is approved is not bound by its terms unless it has agreed to be bound. The creditor can continue with the execution. The practical impact of this is that the arrangement proposal will in effect have to promise the execution creditor full payment in order to obtain its approval.

The potential problem for the execution creditor who agrees to such a voluntary arrangement occurs in the event that the arrangement fails. What happens to assets held by the supervisor on the premature ending of an arrangement has been the subject of some controversy¹⁸¹ but has recently been settled by the Court of Appeal.¹⁸² It is generally assumed by the courts that if a voluntary arrangement does fail, creditors who are owed money are returned to the position they were in prior to the arrangement being entered into, with credit given for any sums of money received under the arrangement whilst it was on foot.¹⁸³ The problem which arises here for the execution creditor is that if the debtor goes into bankruptcy or liquidation following the demise of the voluntary arrangement (which would normally be the case) then the creditor is no longer in the position of a secured creditor. Under the provisions dealing with bankruptcy and liquidation the creditor would be unable to continue with the execution (without leave of the court) and would be reduced to the ranks of unsecured creditors. The obvious consequence of this is that the execution creditor is unlikely to see much if any of the debt owed and is reduced from a very powerful position under the arrangement to one of great weakness.

180 *Ibid.* at 341 per Martin Mann QC.

181 See e.g. P. Walton, 'Voluntary Arrangements—The Nature of the Beast' (1998) 3 *Receivers, Administrators and Liquidators Quarterly* 267.

182 *Re NT Gallagher and Son Ltd* [2002] 2 BCLC 133.

183 See e.g. *Davis v Martin-Sklan* [1995] BCC 1122 at 1125 per Blackburn J and *Re NT Gallagher and Son Ltd* [2002] 2 BCLC 133 at 140 per Peter Gibson LJ.

The best advice to an execution creditor who has achieved secured creditor status for the purposes of a voluntary arrangement is not to agree to the proposal at all (for fear of it subsequently failing) but to forge ahead with the execution to ensure payment. Such advice flies in the face of the ideal of debtor rescue and rehabilitation inherent in the Insolvency Act but is the logical result of the terms of the Act.

v. Administration

The purpose of a company entering administration is to allow the company to have the benefit of a moratorium from creditor action in order that certain alternative statutory purposes may be achieved. Those purposes are: (i) the rescue of the company; (ii) that the company's assets may be realized in a more beneficial manner than would occur in an immediate winding up; or (iii) that the assets may be realized in order to make a distribution to one or more secured or preferential creditor.¹⁸⁴ Until the Enterprise Act 2002, an administrator could only be appointed by court order. Under the terms of the Enterprise Act, this route is still possible, but it is also now possible for an administrator to be appointed out of court by the holder of a qualifying floating charge, by the company itself or by the company's directors.¹⁸⁵ An administrator has wide powers¹⁸⁶ to conduct the company's business in a bid to satisfy the statutory purpose of the administration. The widely drafted moratorium expressly prevents an execution being continued or commenced without the consent of the administrator or leave of the court.¹⁸⁷ Whether or not the execution creditor is a secured creditor is irrelevant. The execution cannot be continued.

The status of the execution creditor is relevant under Schedule B1 paragraphs 70 and 71 of the Insolvency Act 1986.¹⁸⁸ Paragraph 70 permits the administrator to deal with assets subject to a floating charge without the charge holder's consent. Under paragraph 71 any property subject to other types of security cannot be dealt with by the administrator without the security holder's consent or leave of the court. If leave to deal with secured property is obtained, the administrator must apply the proceeds of sale (or provide the market value if the sale achieves a lesser amount) in discharging the sums payable to the secured creditor.

If the execution creditor is deemed to be the holder of a fixed security in the administration, the administrator can only deal with

184 See Insolvency Act 1986, Sch. B1 para. 3(1).

185 See s. 248 of the Enterprise Act 2002 which effectively replaces the old Part II of the Insolvency Act 1986 with a new Sch. B1 to the Act.

186 See Insolvency Act 1986, Sch. 1 and Sch. B1 paras. 59–72.

187 Insolvency Act 1986, Sch. B1 para. 43(6). For guidance as to when the court will grant leave see *Re Atlantic Computer Systems plc* [1992] Ch 505 at 542–4.

188 These provisions were inserted by s. 248 of the Enterprise Act 2002 and largely replicate the former s. 15 of the Insolvency Act 1986.

the assets subject to the execution by, in effect, paying off the execution creditor. If, for example, the creditor has the benefit of the sheriff's walking possession agreement over all the company's chattels, the administrator will not be able to deal with the chattels without paying out the execution creditor.

Paragraph 71 may have another positive consequence for the execution creditor. It would usually be the case that the process of a company entering administration would cause a floating charge to crystallize. If, as in the example above, this occurs after the sheriff has seized but before sale, under the reasoning in *Evans* the floating charge holder would expect to have priority. Paragraph 70 allows the administrator to use floating charge assets without the consent of the charge holder but paragraph 71 only permits dealing with the assets subject to the execution creditor's security with the creditor's consent or leave of the court. This may allow the execution creditor to be paid out and in the process, effectively, to leapfrog the floating charge. This is likely to become an ever increasingly important issue as administration slowly takes over from administrative receivership under the provisions of the Enterprise Act 2002.

The meaning of the term 'security' for the purposes of administration is defined by section 248(b) as meaning 'any mortgage, charge, lien or other security'. In the context of administration, Lord Browne-Wilkinson in *Bristol Airport plc v Powdrill*¹⁸⁹ stated:

Security is created where a person ('the creditor') to whom an obligation is owed by another ('the debtor') by statute or contract, in addition to the personal promise of the debtor to discharge the obligation, obtains rights exercisable against some property in which the debtor has an interest in order to enforce the discharge of the debtor's obligation to the creditor. Whilst not holding that that is a comprehensive definition of 'security,' in my judgment it is certainly no wider than the ordinary meaning of the word.¹⁹⁰

The definition of security contained in section 248 is in the same terms as the definition in section 383,¹⁹¹ where in the context of voluntary arrangements the court has held that seizure under a *fi.fa.* is enough to constitute the execution creditor a secured creditor.¹⁹² The definition would also seem to include an interim charging order. As submitted above, an execution creditor under an interim (or final) third party debt order will not be constituted a secured creditor for these purposes.

¹⁸⁹ [1990] Ch 744 at 760C.

¹⁹⁰ Adopted by Lightman J in *Razzaq v Pala* [1998] BCC 66 at 70.

¹⁹¹ Defined as 'a mortgage, charge, lien or other security'.

¹⁹² *Peck v Craighead* [1995] 1 BCLC 337.

An execution creditor who has become a secured creditor prior to the administration is in a very strong position. Although the creditor cannot continue with the execution without leave of the court, the likelihood is that the administrator will need to use the assets subject to the security in the administration and so the execution creditor will almost be guaranteed to be paid. This position is in sharp contrast to that if the administrator is discharged and the company goes into liquidation.¹⁹³ If the execution creditor remains unpaid at the end of the administration, in a subsequent winding up, as has previously been explained, the creditor will almost certainly be reduced to the ranks of the unsecured creditors.

IV. Possible Reforms

Some clarification as to the rights acquired by execution creditors is needed. As the law currently stands there is considerable divergence of opinion as to whether or not execution creditors become secured creditors at all and if they do, at what stage of the various execution procedures such status is achieved. The formal insolvency procedures available under the Insolvency Act treat execution creditors differently. In the non-terminal procedures their status of secured creditors is recognized, even though the rules for determining secured status seem to vary between the procedures, and in the terminal procedures their rights are virtually overridden.

In the past it has been suggested that there should be no problem in recognizing execution creditors as secured creditors as long as the fact can be discovered by other creditors dealing with the debtor.¹⁹⁴ One of the problems with recognizing execution creditors as secured creditors is that, for example, a search at Companies House against a company will not show that an execution creditor has become secured. To this end some form of registration of the secured status could be made publicly so that no one is misled as to the position of the debtor (some form of public registration is currently available for charging orders). The law as to which events create secured creditor status would need to be clarified. Once this was done the effect of being a secured creditor would be postponed until registration of the event is made. This would seem a sensible and necessary tidying up

193 A common occurrence even where the administration has been a success—see e.g. *Re UCT (UK) Ltd* [2001] 1 BCLC 443; *Re Mark One (Oxford Street) plc* [2000] 1 BCLC 462 and *Re Powerstore (Trading) Ltd* [1998] 1 BCLC 90.

194 D. Hare and D. Milman, above n. 9 at 65 in response to the objection that execution creditors could surreptitiously obtain priority over other creditors (an objection reflected in *D Wilson (Birmingham) Ltd v Metropolitan Property Developments Ltd* [1975] 2 All ER 814 and *Rainbow v Moorgate Properties Ltd* [1975] 1 WLR 788.

suggestion and could be usefully looked at by the Law Commission under its current consultation on registration of security interests.¹⁹⁵

Most people would recognize that creditors in insolvency procedures must be treated equally but that in itself is of little help. Creditors who are secured will have priority over those who are unsecured and so the fundamental issue as to whether execution creditors should be treated as secured creditors at all remains the stumbling block. There is a strong argument that unsecured creditors who diligently obtain judgment and proceed to enforcement should be regarded differently from ordinary unsecured creditors. Their diligence should be rewarded. This seems to be the policy underpinning the rules applicable in voluntary arrangements, administrations and to a limited extent in receivership. In liquidation and bankruptcy this diligence is ignored and the execution creditors are returned to the ranks of the unsecured creditors. Although this divergence could be explained upon the basis that terminal and non-terminal procedures should be viewed differently, it is not an altogether tenable position especially when one considers the impact of transition from non-terminable to terminable procedures. Whatever is the favoured policy it is submitted that the rules should be redrafted in simpler terms in a single provision and be the same for all formal insolvency procedures.

V. Conclusion

Judgment creditors have a number of options available to enforce their judgments. As long as the judgment debtor has sufficient assets and does not enter any formal insolvency procedure, any of these options are likely to be met with some success. The issue as to whether or not execution creditors become secured and if so, at what point in the procedure, will matter little to them.

Secured creditor status may be essential if the judgment debtor does enter insolvency. Problems for the execution creditor thereafter abound. The type of execution chosen, the extent to which it has been completed and the type of insolvency procedure entered by the debtor will all have a bearing on whether or not the creditor is protected by a newly found secured creditor status. The law is particularly uncertain and unsatisfactory in dealing with the common priority dispute between floating charge holders and execution creditors. The effects on execution creditors of the judgment debtor's transition from non-terminal to terminal insolvency procedures are also far from certain.

195 Law Commission, *Registration of Security Interests: Company Charges and Property other than Land* (2002) CP No. 164—execution creditors' interests are outside the Law Commission's terms of reference as currently stated but it is submitted such terms should either be extended or that the Law Commission's eventual recommendations be considered by the Lord Chancellor as part of the Enforcement Review.

It seems strange that, in a climate where the government is ostensibly trying to improve the lot of unsecured creditors in insolvency procedures¹⁹⁶ and to improve enforcement provisions generally,¹⁹⁷ little thought appears to have been given to the fundamental problems encountered by execution creditors on the insolvency of the judgment debtor.

196 By the abolition of the Crown's preferential status by s. 251 of the Enterprise Act 2002 and under the new s. 176A of the Insolvency Act 1986, the introduction of a reserved proportion of any floating charge realizations to be used exclusively for the benefit of unsecured creditors (where the company is in liquidation, administration or receivership).

197 Under the Lord Chancellor's ongoing *Review of Enforcement of Civil Court Judgments*.

Inclusive Bibliography

NB The University's academic regulations require an "inclusive bibliography" to be included as part of the materials submitted. The regulations do not define what is meant by "inclusive bibliography". This bibliography includes books, articles and reports referred to in the published material. It does not include tables of cases or statutes.

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